NO. 83579-9

SUPREME COURT OF THE STATE OF WASHINGTON

LAMTEC CORPORATION,

Petitioner,

v.

DEPARTMENT OF REVENUE, STATE OF WASHINGTON,

Respondent.

RESPONDENT DEPARTMENT OF REVENUE'S SUPPLEMENTAL BRIEF

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ORIGINAL

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I. INTRODUCTION

Over twenty years ago, this Court established the modern test for determining whether an out-of-state seller of goods has sufficient nexus with a state to allow taxation of the seller without running afoul of the dormant Commerce Clause of the United States Constitution. In *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 105 Wn.2d 318, 715 P.2d 123 (1986), this Court held that a seller has sufficient nexus with Washington to be subject to taxation if its in-state activities are significantly associated with establishing and maintaining a market in the state. *Id.* at 323. The United States Supreme Court adopted the standard announced by this Court, and subsequent case law reinforces that this standard remains the law for determining which out-of-state sellers are subject to Washington's business and occupation (B&O) tax on wholesale sales. *Tyler Pipe Indus., Inc. v. Wash. Dep't of Revenue*, 483 U.S. 232, 251, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987); *General Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 49, 25 P.3d 1022 (applying *Tyler Pipe* standard to uphold city B&O tax), *review denied*, 145 Wn.2d 1014 (2001), *cert. denied*, 535 U.S. 1056 (2002). Lamtec Corp. (Lamtec) asks this Court to abandon its prior holding but provides no legal precedent nor sound policy reason for doing so.

Applying the *Tyler Pipe* standard, Lamtec has sufficient nexus with Washington to be subject to tax because Lamtec regularly sends sales representatives into Washington with the specific purpose of marketing its products and maintaining its customers through in-person meetings. These in-state activities are significantly associated with maintaining and establishing a market in the State and thus satisfy the *Tyler Pipe* standard.

II. STATEMENT OF THE CASE

Lamtec sells over $1.1 million of insulation materials to Washington customers each year. CP 429. Lamtec sells on a continuous basis to a handful of Washington customers, who are long-standing customers who make purchases year-round and from year to year.[1] CP 286-89; 339-40. Given this business model, rather than expending effort and resources to obtain new customers in Washington, Lamtec's marketing focus is on maintaining the customer base it already has. CP 285-86, 339-41, 372-73.

As part of its effort to maintain existing customers, Lamtec regularly sends sales representatives on personal visits to Washington customers. Three Lamtec employees visited Washington for this purpose during the tax period for a total of at least 7-11 days per year. CP 76-78; 312; 335; 360; 372; 383-84; 389-98.

[1] Over the entire seven years of the tax period, Lamtec had at most 12 customers. CP 312-13.

Lamtec admits that the purpose of these visits to Washington customers was to maintain the customer relationship in order to encourage continued purchases from Lamtec. CP 294-95; 337-40, 374. Lamtec sales representatives generally described the visits as providing information to customers, listening to customer concerns about Lamtec products, providing "good customer service," participating in telephone calls with customers to Lamtec's technical or customer service departments, fielding questions about potential price increases or new products, and general client relations. *See generally* CP 338-44; 371, 373-74; 385-86. As part of its marketing efforts, Lamtec sales representatives also sometimes left brochures and product samples when visiting with Washington customers. CP 343-45; 375; 408-13. Lamtec considered the physical, in-person visits by its sales representatives significant to its business model and marketing program and would not consider abandoning the visits. CP 295-96, 345-46.

III. STATEMENT OF THE ISSUE

The Washington Supreme Court and United States Supreme Court have held that an out-of-state corporation that makes wholesale sales to Washington customers has sufficient nexus for Commerce Clause purposes to be subject to Washington's B&O tax if its in-state activities are significantly associated with establishing and maintaining a market in

Washington. Does Lamtec have sufficient "nexus" under the Commerce Clause to be subject to Washington tax when it makes annual sales of over $1.1 million to a handful of Washington customers, and its employees make regular, in-person visits to Washington customers, which Lamtec considers significant to its business and marketing program?

IV. ARGUMENT

A. Lamtec Has The Burden To Show That Imposition Of Washington's B&O Tax Violates The Commerce Clause.

In Washington, a taxpayer has the burden to prove that an assessed tax is incorrect. RCW 82.32.180. Thus, a taxpayer seeking to avoid taxation based on Commerce Clause principles must show that the tax violates the Commerce Clause. While the Commerce Clause prevents states from unduly burdening interstate commerce, "[i]t is not the purpose of the Commerce Clause 'to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business.'" *General Motors*, 107 Wn. App. at 50 (quoting *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 182, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995)).

A state tax on interstate commerce is valid if it: 1) is applied to an activity with a substantial nexus with the taxing State; 2) is fairly apportioned; 3) does not discriminate against interstate commerce; and 4)

is fairly related to the services provided by the State. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977). Lamtec has raised only the nexus prong of this four-part test.[2]

B. Lamtec Has Sufficient Nexus With Washington To Be Subject To Tax.

This Court and the United States Supreme Court long ago established the standard for determining whether an out-of-state business can avoid Washington's B&O tax on engaging in wholesale sales for sales made to Washington. That standard is "whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Tyler Pipe*, 483 U.S. at 250 (reviewing and upholding this Court's analysis in *Tyler Pipe*, 105 Wn.2d at 323). *See also* WAC 458-20-193(2)(f) (adopting *Tyler Pipe* standard for nexus). Subsequent decisions have confirmed and applied this standard. *E.g., General Motors*, 107 Wn. App. at 49.

An out-of-state business need not solicit or accept orders within the taxing state to have sufficient Commerce Clause nexus. *Standard Pressed Steel Co. v. Wash. Dep't of Revenue*, 419 U.S. 560, 562-64, 95 S. Ct. 706,

[2] Washington courts have already definitively addressed the second and third prongs of the test with respect to the tax at issue, upholding the B&O tax on wholesale sales as non-discriminatory and inherently apportioned. *E.g., W.R. Grace & Co. – Conn. v. Dep't of Revenue*, 137 Wn.2d 580, 596-97, 973 P.2d 1011, *cert. denied*, 528 U.S. 950 (1999).

42 L. Ed. 2d 719 (1975); *General Motors*, 107 Wn. App. at 52 ("Although the automakers place great emphasis on the fact that they engage in no direct selling activities in Seattle, substantial nexus has never turned on this distinction.") Rather, the court looks more generally at whether the activities in the state are purposeful and designed to maintain a market in the state. *General Motors*, 107 Wn. App. at 52.

In *Standard Pressed Steel*, the Court held that Washington could constitutionally tax sales to a Washington customer by an out-of-state manufacturer where the out-of-state manufacturer employed one person who resided and worked in Washington. 419 U.S. at 561, 564. The single employee did not solicit sales or receive orders. *Id.* at 561. The out-of-state business maintained no office, no sales force, and no plant in Washington. *Id.* The employee's "primary duty was to consult with [the purchaser] regarding the anticipated needs and requirements for aerospace fasteners and to follow up any difficulties in the use of [out-of-state manufacturer's] product after delivery." *Id.* Additional employees of the manufacturer visited Washington to assist the single employee in these tasks. *Id.* The Court had no trouble upholding Washington's B&O tax against a Commerce Clause nexus challenge, stating that the taxpayer's argument "verges on the frivolous." *Id.* at 562.

In the present case, Lamtec has substantial nexus with Washington because its activities within Washington are significantly associated with establishing and maintaining a market in the state. Lamtec witnesses were unanimous in testifying that a purpose of the visits to Washington by Lamtec sales representatives was to maintain Lamtec's customer base to ensure continued purchases from those customers. The visits were regular and initiated by Lamtec. Lamtec's own witnesses attested to the importance of these visits given Lamtec's business model and marketing approach, and Lamtec would not even consider abandoning the visits. CP 295-96, 345-46. Just as the single employee in *Standard Pressed Steel* was important to maintaining the market for the out-of-state taxpayer despite not being engaged in solicitation or acceptance of sales orders, Lamtec's three employees who made in-person visits to Washington were important to maintaining its Washington market.

Although in its briefing Lamtec characterizes the employee visits as primarily social, the undisputed evidence before the trial court in the form of testimony by the Lamtec employees themselves demonstrates otherwise.[3] *E.g.,* CP 371 ("My role has been . . . to meet with our existing

[3] Even if Lamtec's characterization of the visits as primarily social were accurate, such a conclusion would not prevent application of the *Tyler Pipe* standard to the in-state activity. As the trial court recognized, "not all business is done 8:00 to 5:00 in a sales room, but it is more likely that the dinner parties, the cocktail parties, the golf tournaments, the social setting is very important to business." RP 4.

customer base, basically maintain our relationship with that customer and typically a factual type meeting where I bring them up to date in on what is happening with our company and I inquire as to what their opinion is of our operations and our service capability as to their needs.") As the Court of Appeals summarized, "Lamtec employees provided information, listened to concerns about and answered questions concerning Lamtec products, participated in telephone calls that the customers placed to Lamtec's technical and customer service departments in New Jersey, fielded questions concerning potential price increases and new products, and maintained general client relations." *Lamtec Corp. v. Dep't of Revenue*, 151 Wn. App. 451, 215 P.3d 968 (2009). Lamtec has not complained about the Court of Appeals recitation of facts, and in any event these facts are amply supported in the record. *See* Resp. Br. at 4-5, 26-27 and record cited therein.

Lamtec's in-person visits to its customers are particularly important to maintaining its market given its business model and marketing approach. Lamtec is not in the business of making occasional, one-time sales to a multitude of customers. Instead, Lamtec cultivates a small number of high-volume and long-term customers that it seeks to maintain through good customer service, which includes in-person visits. CP 289, 295-96, 339-40, 345-46 (testimony that it would be a "poor

business practice" not to visit customers in person and that given Lamtec's business model it was very important to maintain good relationships with existing customers); CP 339-40 ("We have long established customers and long established relationships. It's not a fickle industry.") Thus, Lamtec's marketing focus in Washington is on maintaining the customer base it already has rather than finding new customers. CP 339-41.

As both the trial court and the Court of Appeals found, given Lamtec's business model, the in-person visits were significantly associated with establishing and maintaining a market in Washington. Accordingly, Lamtec is subject to Washington's wholesaling B&O tax.

C. Persuasive Authority Corroborates That Lamtec Has Sufficient Nexus With Washington To Be Subject To Tax.

Decisions by courts in other jurisdictions and the Washington Board of Tax Appeals have upheld taxation in cases similar to the present case. *Orvis Co. Inc. v. Tax Appeals Tribunal of New York*, 86 N.Y.2d 165, 654 N.E.2d 954, *cert. denied*, 516 U.S. 989 (1995); *Carr Lane Mfg. Co. v. Dep't of Revenue*, Bd. Tax Appeals No. 54917 (2001).[4] *See also Arizona Dep't of Revenue v. Care Computer Systems, Inc.*, 197 Ariz. 414, 4 P.3d 469 (2000) (finding substantial nexus where sales representative visited

[4] Board of Tax Appeals opinions can be persuasive authority, just as court decisions from other states can be persuasive. *See Seattle FilmWorks, Inc. v. Dep't of Revenue*, 106 Wn. App. 448, 459, 24 P.3d 460, *review denied*, 145 Wn.2d 1009 (2001).

state approximately one time per year and training personnel were sent into state on regular basis).

The New York Court of Appeals in *Orvis* found sufficient Commerce Clause nexus for a use tax collection obligation based on non-solicitation visits by the taxpayer's employees to the taxing state. *Orvis*, 654 N.E.2d at 962. The *Orvis* court addressed the cases of two taxpayers. In the first case, the court held that an average of four visits a year to as many as nineteen wholesale customers was sufficient to establish nexus.[5] *Id.* at 961. In the second case, the *Orvis* court upheld taxation based on 41 non-solicitation visits in the state over three years. *Id.* at 962. The visits were pursuant to the taxpayer's agreement to assist the buyers of software if problems developed after purchase. *Id.* Despite the fact that the visits were not for the purpose of soliciting sales or even specifically directed at marketing, the trouble-shooting visits and the assurances of such visits "enhanced sales and significantly contributed to [taxpayer's] ability to establish and maintain a market . . . in New York." *Id.*

In *Carr Lane*, the Washington Board of Tax Appeals addressed a fact situation nearly identical to the present case, except that the taxpayer's in-state activities in that case were likely less significant than in the

[5] The actual number of visits was disputed in *Orvis*, but the court seemed to base its analysis on the above-cited number. The court's conclusion regarding the purpose of the visits is unclear, but suggests that it rejected the taxpayer's assertion that the visits were not for the purposes of sales promotion. *Orvis*, 654 N.E.2d at 961.

present case. In upholding imposition of B&O tax on wholesale sales activity, the Board held that visits two or three times a year by one employee in order to deliver catalogs and explain new parts and features were sufficient to establish Commerce Clause nexus. *Carr Lane*, at 2-3. The Board reasoned, "the 2 or 3 days a year spent at the Distribution Company is informational as to new products of taxpayer and to provide inserts for the catalog. The purpose of the sales calls was clearly to maintain the Taxpayer's presence in Washington's market." *Id.* at 3. *Accord Dynamic Information Systems Corp. v. Dep't of Revenue*, Bd. Tax Appeals No. 98-84 (2000) (finding substantial nexus for duty to collect use tax where taxpayer visited Washington from 2-9 times per year for 1-4 days each visit in order to demonstrate products and support existing customers).

As these cases show, non-permanent employee visits to the taxing state constitute sufficient Commerce Clause nexus to allow taxation provided that the visits are significantly associated with establishing and maintaining a market in the state.[6] If anything, Lamtec's in-state activities

[6] Cases from other jurisdictions that have found insufficient Commerce Clause nexus are distinguishable and reinforce the Court of Appeals and trial court decisions in this case. For example, in *In re Intercard, Inc.*, the Kansas Supreme Court held that 11 visits over a four-year period in order to install a component of its product was not sufficient to establish nexus. *In re Intercard*, 14 P.3d 1111, 1113, 1122-23 (Kan. 2000). In reaching its decision, the *Intercard* court relied on the facts that the visits were "isolated" and "sporadic." *Id.* at 1122. The court affirmed the opinion below, which reasoned that the visits were very minor activities, were solely at the customer's request

are even more significant than those in *Carr Lane* and *Orvis*. Unlike the taxpayers in those cases, Lamtec admits that its purpose in visiting Washington is to maintain its customers to ensure continued purchases, admits that the visits are part of its marketing, and attests to the importance of the visits by stating that it had not considered abandoning the visits because that would be a "poor business practice." CP 294-96, 298, 337-40, 345-46, 374. Accordingly, Lamtec's in-state activities establish sufficient nexus to subject it to Washington's B&O tax.

D. Lamtec Cannot Take Advantage Of The Physical Presence "Safe Harbor."

Subsequent to *Tyler Pipe*, the United States Supreme Court reaffirmed a "safe harbor" allowing taxpayers to avoid certain taxation by a state if they have no physical presence in the state. *Quill Corp. v. North Dakota*, 504 U.S. 298, 315, 317-18, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992). However, the *Quill* "safe harbor" has no application in this case

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and that the visits were not used in any way to promote the sales of its products. *Id.* at 1114. Similarly, a Florida court found no substantial nexus where the presence of taxpayer's employees for three days a year was not for the purpose of developing a market in Florida. *Florida Dep't of Revenue v. Share Int'l, Inc.*, 667 So.2d 226 (Fla. Ct. App. 1995), *aff'd*, 676 So.2d 1362 (1996), *cert. denied*, 519 U.S. 1056 (1997). In *Share Int'l*, the taxpayer attended a seminar in Florida for three days out of the year, during which it promoted its products and received some orders for sales. *Id.* at 230. However, the seminar included mostly out-of-state participants, the seminar was held in winter months specifically to encourage out-of-state participants, and the trial court found that the taxpayer "did not create a customer base in Florida during its presence at the seminars and did not exploit the consumer market in Florida." *Id.* In contrast, Lamtec engaged in regular, in-state activities for the express purpose of maintaining its customers and general marketing.

because Lamtec has a physical presence in Washington. Lamtec sales representatives made regular calls on customers in Washington to maintain Lamtec's customer base to ensure continued purchases from these customers.

The *Quill* Court was reviewing the "safe harbor" first established in an earlier decision, *National Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967). Both *Quill* and *Bellas Hess* involved a state's attempt to require an out-of-state mail-order business to collect and remit use tax when the mail-order business's "only connection with customers in the State [was] by common carrier or the United States mail." *Quill*, 504 U.S. at 301 (quoting *Bellas Hess*, 386 U.S. at 758). The *Bellas Hess* rule had been called into question because of the evolution of Supreme Court jurisprudence regarding due process "minimum contacts" and the advances of technology that would address some of the concerns expressed in *Bellas Hess*. *Quill*, 504 U.S. at 314. The *Quill* Court agreed that the Due Process Clause did not require any physical presence in the state and was satisfied by the taxpayer's purposefully directing its activities to the state and taking advantage of its market. *Id.* at 308. However, the Court clarified that its nexus analysis was animated not only by the Due Process Clause, but also by the Commerce Clause. *Id.* at 312.

With respect to Commerce Clause nexus, the Court upheld the *Bellas Hess* safe harbor based in large part on principles of stare decisis and because the mail-order industry had relied upon the rule. *Id.* at 311 (upholding *Bellas Hess* despite acknowledging that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today.") The Court described its ruling as a "safe harbor" and a "bright-line" rule that protected vendors whose only contact with a state was through the mail or common carriers. *Id.* at 314-15.

Lamtec argues that *Quill* requires a "small sales force, plant, or office" within the taxing state. Pet. Rev. at 8. The *Quill* Court established no such requirement, but merely cited to examples of what would satisfy a physical presence requirement from prior cases. *Quill*, 504 U.S. at 315. Indeed, the Court in *Standard Pressed Steel* upheld Washington's B&O tax despite the absence of a sales force, plant or office, and there is no suggestion that *Quill* overruled that holding. *Standard Pressed Steel*, 419 U.S. at 561; *see also Quill*, 504 U.S. at 314 (agreeing with the lower court's analysis regarding *Standard Pressed Steel* and stating that there was a physical presence in that case). The Department is unaware of any published opinion that imposes such a requirement, and the persuasive authority discussed above contradicts Lamtec's assertion.

In this case, Lamtec cannot take advantage of the *Quill* safe harbor because it crossed the "bright line" endorsed by the *Quill* opinion by regularly sending its sales representatives to Washington to meet with customers. Accordingly, the *Quill* safe harbor does not apply in this case.

Because *Quill* does not apply here, it is unnecessary for this Court to consider whether *Quill* is limited to sales and use taxes or whether it also applies to Washington's wholesaling B&O tax. There is undoubtedly debate about whether the *Tyler Pipe* standard requires a physical presence in the taxing state to uphold a gross receipts tax on the sale of goods. *See, e.g.*, Walter Hellerstein, *State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication*, 41 Tax Lawyer 37, 66-67 (1987-88). But the question of whether *Quill* applies to Washington's wholesaling B&O tax and whether *Tyler Pipe* requires a physical presence are not presented in this case because Lamtec does have a physical presence in Washington. There is thus no need for this Court to wade into what even the United States Supreme Court has called the "quagmire" of Commerce Clause jurisprudence to resolve these questions. *See Quill*, 504 U.S. at 315. This Court generally will not decide constitutional questions unless absolutely necessary to decide the case before it and should refrain from doing so here. *E.g., City of Seattle v. Williams*, 128 Wn.2d 341, 347, 908 P.2d 359 (1995). Furthermore, given

recent statutory enactments, this Court may never be called upon to determine this question. *See* Laws of 2010, ch. 23, § 104 (6) (requiring physical presence of taxpayer for imposition of B&O tax on wholesale and retail sales).[7]

If this Court were to consider whether the physical presence safe harbor applies beyond sales and use taxes, the Department respectfully submits that the language of *Quill* and the great weight of authority from Washington and other states is that the physical presence safe harbor is limited to sales and use taxes. *E.g., Quill*, 504 U.S. at 311 ("[W]e have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for *sales and use taxes*[.]") (emphasis added); at 315 ("Under *Bellas Hess* [vendors whose only connection with the taxing state is by mail or common carrier] are free from state-imposed duties to collect *sales and use taxes*") (emphasis added); at 315 ("Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect *sales and use taxes* and reduces litigation concerning those taxes.") (emphasis added); at 316 ("a bright-line rule in the area of *sales and use taxes* also encourages settled expectations . . . .") (emphasis added); at 317 (declining to reject

[7] The recently enacted statute does not impose a physical presence requirement for other types of B&O taxes, such as taxes on services. *See* Laws of 2010, ch. 23, § 104 (1) – (5). Whether such taxes require a physical presence merits an entirely different analysis and is not presented in this case.

rule that *Bellas Hess* established "in the area of *sales and use taxes*.") (emphasis added). *See also General Motors*, 107 Wn. App. at 55; *Vonage America, Inc. v. City of Seattle*, 152 Wn. App. 12, 26-27, 216 P.3d 1029 (2009) (questioning application of *Quill* physical presence requirement beyond sales and use taxes); and state cases cited in the Department's Answer to Petition for Review, at 11 n.6. *See also* Walter Hellerstein & John A. Swain, *Classifying State and Local Taxes: Current Controversies*, 54 State Tax Notes 35 (October 5, 2009) (concluding that *Quill* probably does not apply to Washington's B&O tax) (attached as Appendix 8).

E. Lamtec Relies On Inapplicable Authority.

To support its argument that Lamtec can avoid Washington's B&O tax on its wholesale sales to Washington customers, Lamtec relies on a Washington case that did not involve interstate commerce or the Commerce Clause. App. Br. at 17-18, Pet. for Rev. at 9 (citing *City of Tacoma v. Fiberchem, Inc.*, 44 Wn. App. 538, 722 P.2d 1357, *review denied*, 107 Wn.2d 1008 (1986)). The *Fiberchem* court addressed intrastate transactions and relied on the Due Process Clause, not the Commerce Clause. *Id.* at 539, 544 n.1. Consequently, it did not apply or even cite the four-part *Complete Auto* test set forth above, nor did it apply or cite this Court's then-recently decided *Tyler Pipe* decision. *Fiberchem*,

44 Wn. App. at 543-45. Subsequent case law and the Court of Appeals in this case have recognized that *Fiberchem* was not applicable to a Commerce Clause nexus analysis. *Lamtec*, 151 Wn. App. at 466; *General Motors*, 107 Wn. App. at 53.

Not only does Lamtec incorrectly seek to use the *Fiberchem* opinion as precedent for a Commerce Clause analysis, but it also effectively urges this Court to abandon its Commerce Clause nexus analysis – one that has been specifically approved and adopted by the United States Supreme Court – in favor of the analysis used in *Fiberchem*. Pet. Rev. at 9. The Department respectfully requests that the Court reject this proposal.

Moreover, *Fiberchem* has been implicitly overruled by *Quill*, which established that the Due Process Clause required only "purposeful availment" of the benefits of a market in order to be subject to tax and required no physical presence. *Quill*, 504 U.S. at 308. The *Fiberchem* court had relied on prior Washington case law that in turn applied Fourteenth Amendment due process limits on interstate taxation. *Fiberchem*, 44 Wn. App. at 544, n.1 (citing, *inter alia*, *Dravo Corp. v. Tacoma*, 80 Wn.2d 590, 496 P.2d 504 (1972)). At the time that *Fiberchem* and the cases it relied on were decided, the United States Supreme Court had not delineated what part of its nexus analysis stemmed

from the Due Process Clause and what part from the Commerce Clause. *E.g., Quill*, 504 U.S. at 305 (noting that the Court had not always been precise in distinguishing the Due Process and Commerce Clause analyses); Walter Hellerstein, *State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication*, 41 Tax Lawyer 37, 52 (1987-88). Now that *Quill* has definitively outlined the contours of Due Process and Commerce Clause nexus analysis, it is apparent that the basis of *Fiberchem*'s holding has been overruled. *See Quill*, 504 U.S. at 308 ("[T]o the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of duty to collect a use tax, we overrule those holdings as superseded by developments in the law of due process.") Accordingly, the Department respectfully requests that the Court recognize that *Fiberchem* is no longer good law.

V. CONCLUSION

Lamtec has for many years availed itself of the benefits of Washington's market, making over $1 million dollars of annual sales and regularly sending sales representatives into the state to meet with its customers in order to maintain its market. Requiring Lamtec to abide by Washington's tax laws creates no undue burden on interstate commerce, but merely ensures that Lamtec bears its fair share of the state's tax

burden. Accordingly, the Department respectfully requests that the Court affirm the Court of Appeals.

RESPECTFULLY SUBMITTED this 7th day of May, 2010.

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APPENDIX

1. *Tyler Pipe Indus., Inc. v. Wash. Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L.Ed.2d 199 (1987)

2. *Standard Pressed Steel Co. v. Washington Dep't of Revenue*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975)

3. *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992)

4. *Orvis Co. Inc. v. Tax Appeals Tribunal of New York*, 86 N.Y.2d 165, 654 N.E.2d 954, *cert. denied*, 516 U.S. 989 (1995)

5. *Arizona Dep't of Revenue v. Care Computer Systems, Inc.*, 197 Ariz. 414, 4 P.3d 469 (2000)

6. *Carr Lane Mfg. Co. v. Dep't of Revenue*, Bd. Tax Appeals No. 54917 (2001)

7. *Dynamic Information Systems Corp. v. Dep't of Revenue*, Bd. Tax Appeals No. 98-84 (2000)

8. Walter Hellerstein & John A. Swain, *Classifying State and Local Taxes: Current Controversies*, 54 State Tax Notes 35 (October 5, 2009)

Westlaw

107 S.Ct. 2810
483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199, 55 USLW 4978
(Cite as: 483 U.S. 232, 107 S.Ct. 2810)

Supreme Court of the United States
TYLER PIPE INDUSTRIES, INC., Appellant
v.
WASHINGTON STATE DEPARTMENT OF REVENUE.
NATIONAL CAN CORPORATION, et al., Appellants
v.
WASHINGTON STATE DEPARTMENT OF REVENUE.
Nos. 85-1963, 85-2006.

Argued March 2, 1987.
Decided June 23, 1987.

Suits were brought challenging constitutionality of Washington business and occupation tax. The Superior Court, Thurston County, Washington, Carol A. Fuller, J., and Orris L. Hamilton, J., pro tem., upheld constitutionality of tax, and taxpayers appealed. The Washington Supreme Court, 105 Wash.2d 318, 715 P.2d 123 and 715 P.2d 128,superseded at 105 Wash.2d 327, 732 P.2d 134, affirmed. Taxpayers appealed. The Supreme Court, Justice Stevens, held that: (1) multiple activities exemption from manufacturing tax, whereby manufacturers selling products within the State of Washington and paying wholesale tax were not subject to the manufacturing tax, discriminated against interstate commerce in violation of the commerce clause; (2) manufacturing and wholesaling were not "substantially equivalent events" such that taxing the manufacture of goods sold outside the state could be said to compensate for the state's inability to impose a wholesale tax on those goods; (3) activities of an out-of-state corporation's sales representatives in Washington adequately supported the state's jurisdiction to impose its wholesale tax on that corporation; (4) wholesaling had to be viewed as a separate activity conducted wholly within Washington that no other state had jurisdiction to tax, so that it was not required that the burden of the wholesale tax on out-of-state corporation be apportioned between its activities in Washington and its activities in other states; and (5) it was appropriate for the Supreme Court of Washington to address in the first instance the refund issues raised by the rulings in the present cases.

Vacated and remanded.

Justice O'Connor filed a concurring opinion.

Justice Scalia, with whom the Chief Justice joined in part, filed an opinion concurring in part and dissenting in part.

Justice Powell took no part.

Opinion on remand, 109 Wash.2d 878, 749 P.2d 1286.

West Headnotes

[1] Commerce 83 ⇐63.10

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Washington's business and occupation tax on manufacturing discriminated against interstate commerce in violation of the commerce clause where the statute provided a multiple activities exemption for manufacturers selling their products within the state, even though such manufacturers paid a

wholesale tax at the same rate, where there was no exemption for wholesale taxes paid to other states; nor could the facial unconstitutionality of the tax be alleviated by examining the effect of legislation enacted by sister states to determine whether specific interstate transactions were subjected to multiple taxation; overruling *General Motors Corp. v. Washington*, 377 U.S. 436, 84 S.Ct. 1564, 12 L.Ed.2d 430. U.S.C.A. Const. Art. 1, § 8, cl. 3; West's RCWA 82.04.220, 82.04.270, 82.04.240, 84.04.440.

[2] Licenses 238 ⚖7(1)

238 Licenses
238I For Occupations and Privileges
238k7 Constitutionality and Validity of Acts and Ordinances
238k7(1) k. In General. Most Cited Cases
Manufacturing and wholesaling are not "substantially equivalent events" such that taxing, under Washington's business and occupation tax, the manufacture of goods sold outside the state could be said to compensate for the state's inability to impose a wholesale tax on those goods. U.S.C.A. Const. Art. 1, § 8, cl. 3; West's RCWA 82.04.220, 82.04.270, 82.04.240, 84.04.440.

[3] Commerce 83 ⚖74.20

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k74.20 k. Gross Receipts Taxes. Most Cited Cases
Showing of sufficient nexus with state to justify state's collection of a gross receipts tax on a particular company's sales cannot be defeated by argument that the company's representative is properly characterized as an independent contractor instead of an agent; rather, the crucial factor governing nexus is whether the activities performed in the state on behalf of the company are significantly associated with its ability to establish and maintain a market in the state for its sales.

[4] Commerce 83 ⚖63.10

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k63 Licenses and Privilege Taxes
83k63.10 k. Particular Subjects and Taxes. Most Cited Cases

Licenses 238 ⚖7(1)

238 Licenses
238I For Occupations and Privileges
238k7 Constitutionality and Validity of Acts and Ordinances
238k7(1) k. In General. Most Cited Cases
Activities of out-of-state corporation's sales representatives supported jurisdiction of the State of Washington to impose its wholesale tax on the corporation, where the sales representatives acted daily in calling on customers and soliciting orders on behalf of the corporation and had long-established and valuable relationships with the corporation's customers.

[5] Commerce 83 ⚖62.80

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k62.70 Taxation in General
83k62.80 k. Multiple Taxation; Apportionment. Most Cited Cases

Licenses 238 ⚖30

238 Licenses
238I For Occupations and Privileges
238k27 License Fees and Taxes
238k30 k. Levy and Assessment. Most Cited Cases
Activity of wholesaling in Washington, whether by in-state or out-of-state manufacturers, had to be viewed as a separate activity conducted wholly within Washington that no other state had the juris-

diction to tax, and thus Washington could properly impose wholesale tax without apportionment of tax burden between activities of out-of-state corporation in Washington and activities in other states. West's RCWA 82.04.270.

[6] Courts 106 ⇐489(9)

106 Courts
106VII Concurrent and Conflicting Jurisdiction
106VII(B) State Courts and United States Courts
106k489 Exclusive or Concurrent Jurisdiction
106k489(9) k. Suits Brought Under Interstate Commerce Act. Most Cited Cases
It was appropriate for state Supreme Court to address in the first instance issues of refund and retroactive application of decision that manufacturing tax discriminated against interstate commerce in violation of the commerce clause. U.S.C.A. Const. Art. 1, § 8, cl. 3; West's RCWA 82.04.220, 82.04.240, 82.04.440.

****2811 *232** *Syllabus* FN*

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

Washington imposes a business and occupation (B & O) tax on the privilege of engaging in business activities in the State, including manufacturing in the State and making wholesale sales in the State. The measure of the wholesale tax is the gross proceeds of sales, and the measure of the manufacturing tax is the value of the manufactured product. However, under the B & O tax's "multiple activities exemption," local manufacturers are exempted from the manufacturing tax for the portion of their output that is subject to the wholesale tax. Application of the exemption results in local****2812** manufacturers' paying the wholesale tax on local sales, local manufacturers' paying only the manufacturing tax on their out-of-state sales, and out-of-state manufacturers' paying the wholesale tax on their sales in Washington. The same tax rate is applicable to both wholesaling and manufacturing activities. In both of the cases under review, which originated as state-court tax refund suits by appellants, local manufacturers who sold their goods outside Washington and out-of-state manufacturers who sold their goods in Washington, the trial court held that the multiple activities exemption did not discriminate against interstate commerce in violation of the Commerce Clause. In No. 85-1963, appellant Tyler Pipe Industries, Inc. (Tyler)-an out-of-state manufacturer who sold its products in Washington but had no property or employees in Washington, and whose solicitation of business in Washington was conducted by an independent contractor located in Washington-also asserted that its business did not have a sufficient nexus with Washington to justify the collection of the tax on its wholesale sales there. The trial court upheld the B & O tax. The Washington Supreme Court affirmed in both cases.

Held:

1. Washington's manufacturing tax discriminates against interstate commerce in violation of the Commerce Clause because, through the operation of the multiple activities exemption, the tax is assessed only on those products manufactured in Washington that are sold to out-of-state customers. The exemption for local manufacturers that sell their products***233** within the State has the same facially discriminatory consequences as the West Virginia tax exemption that was invalidated in *Armco Inc. v. Hardesty*, 467 U.S. 638, 104 S.Ct. 2620, 81 L.Ed.2d 540, and the reasons for invalidating the tax in that case also apply to the Washington tax. The facial unconstitutionality of Washington's tax cannot be alleviated by examining the effect of other States' tax legislation to determine whether specific interstate transactions are subject to multiple taxation. Nor can Washington's imposition of the manufacturing tax on local goods sold outside the

State be saved as a valid "compensating tax." Manufacturing and wholesaling are not "substantially equivalent events," *id.*, at 643, 104 S.Ct., at 2623, such that taxing the manufacture of goods sold outside the State can be said to compensate for the State's inability to impose a wholesale tax on such goods. *Henneford v. Silas Mason Co.*, 300 U.S. 577, 57 S.Ct. 524, 81 L.Ed. 814, distinguished. To the extent that the ruling here is inconsistent with the ruling in *General Motors Corp. v. Washington*, 377 U.S. 436, 84 S.Ct. 1564, 12 L.Ed.2d 430-where the B & O tax was upheld as against claims that it unconstitutionally taxed unapportioned gross receipts and did not bear a reasonable relation to the taxpayer's in-state activities-that case is overruled. Pp. 2816-2821.

2. The activities of Tyler's sales representative in Washington adequately support the State's jurisdiction to tax Tyler's wholesale sales to in-state customers. The showing of a sufficient nexus cannot be defeated by the argument that the taxpayer's representative was properly characterized as an independent contractor rather than an agent. Cf. *Scripto, Inc. v. Carson*, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660. Nor is there any merit to Tyler's contention that the B & O tax does not fairly apportion the tax burden between its activities in Washington and its activities in other States. Such contention rests on the erroneous assumption that, through the B & O tax, Washington is taxing the unitary activity of manufacturing and wholesaling. The manufacturing tax and the wholesaling tax are not compensating taxes for substantially equivalent events, and, thus, the activity of wholesaling-whether by an in-state or an out-of-state manufacturer-must be viewed as a separate activity conducted wholly within Washington that no other State has jurisdiction to tax. Pp. 2821-2822.

****2813** 3. Appellee's argument against retroactive application of any adverse decision here should be considered, in the first instance, by the Washington Supreme Court on remand. Cf. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200. Pp. 2822-2823.

105 Wash.2d 318, 715 P.2d 123, and 105 Wash.2d 327, 732 P.2d 134 (1986), vacated and remanded.

STEVENS, J., delivered the opinion of the Court, in which BRENNAN, WHITE, MARSHALL, BLACKMUN, and O'CONNOR, JJ., joined, and in Part ***234** IV of which SCALIA, J., joined. O'CONNOR, J., filed a concurring opinion, *post*, p. ----. SCALIA, J., filed an opinion concurring in part and dissenting in part, in Part I of which REHNQUIST, C.J., joined, *post*, p. ----. POWELL, J., took no part in the consideration or decision of the cases.
Neil J. O'Brien argued the cause for appellant in No. 85-1963. With him on the briefs was *Peter J. Turner. D. Michael Young* argued the cause for appellants in No. 85-2006. With him on the briefs were *John T. Piper* and *Franklin G. Dinces.*

William Berggren Collins, Assistant Attorney General of Washington, argued the cause for appellee in both cases. With him on the brief were *Kenneth O. Eikenberry,* Attorney General, and *James R. Tuttle, Leland T. Johnson,* and *Timothy R. Malone,* Assistant Attorneys General.†

† *E. Barrett Prettyman, Jr.,* and *John G. Roberts, Jr.,* filed a brief for Amcord, Inc., et al. as *amici curiae* urging reversal in No. 85-2006. *Jean A. Walker* filed a brief for the Committee on State Taxation of the Council of State Chambers of Commerce as *amicus curiae* urging reversal in both cases.

Benna Ruth Solomon and *Mark C. Rutzick* filed a brief for the National Governors' Association et al. as *amici curiae* urging affirmance.

Justice STEVENS delivered the opinion of the Court.

In *Armco Inc. v. Hardesty*, 467 U.S. 638, 104 S.Ct. 2620, 81 L.Ed.2d 540 (1984), we held that West Virginia's gross receipts tax on the business of

selling tangible property at wholesale discriminated against interstate commerce because it exempted local manufacturers. The principal question in these consolidated appeals is whether Washington's manufacturing tax similarly violates the Commerce Clause of the Constitution because it is assessed only on those products manufactured within Washington that are sold to out-of-state purchasers. We conclude that our reasons for invalidating the West Virginia tax in *Armco* also apply to the Washington tax challenged here.

I

For over half a century Washington has imposed a business and occupation (B & O) tax on "the act or privilege of engaging*235 in business activities" in the State. Wash.Rev.Code § 82.04.220 (1985). The tax applies to the activities of extracting raw materials in the State,[FN1] manufacturing in the State,[FN2] making wholesale sales in the State,[FN3] and making retail sales in the State.[FN4] The State has typically applied the same tax rates to these different activities. The measure of the selling tax is the "gross proceeds of sales," and the measure of the manufacturing tax is the value of the manufactured products. §§ 82.04.220, 82.04.240.

FN1. Wash.Rev.Code § 82.04.230 (1985).

FN2. § 82.04.240.

FN3. § 82.04.270.

FN4. § 82.04.250.

Prior to 1950, the B & O tax contained a provision that exempted persons who were subject to either the extraction tax or the manufacturing tax from any liability for either the wholesale tax or the retail tax on products extracted or manufactured in the State.[FN5] Thus, the wholesale tax applied to out-of-state manufacturers but not to local manufacturers. In 1948 the Washington Supreme Court held that this wholesale tax exemption for local manufacturers discriminated against interstate commerce and **2814 therefore violated the Commerce Clause of the Federal Constitution. *Columbia Steel Co. v. State,* 30 Wash.2d 658, 192 P.2d 976 (1948). The State Supreme Court rejected the State's argument that the taxpayer had not suffered from discrimination against interstate commerce because it had not proved that it paid manufacturing*236 tax to another State.[FN6] The Washington Supreme Court also dismissed the State's contention that if the State in which a good was manufactured did not impose a manufacturing tax, the seller of the good would have a competitive advantage over Washington manufacturers:

FN5. The statute provided:

" 'Every person engaging in activities which are within the purview of the provisions of two or more paragraphs (a), (b), (c), (d), (e), (f) and (g) of section 4 [§ 8370-4], shall be taxable under each paragraph applicable to the activities engaged in: *Provided, however, That persons taxable under paragraphs (a) or (b) of said section shall not be taxable under paragraphs (c) or (e) of said section with respect to making sales at retail or wholesale of products extracted or manufactured within this state by such persons,* (Italics ours)." See *Columbia Steel Co. v. State,* 30 Wash.2d 658, 661, 192 P.2d 976, 977-978 (1948).

FN6. " 'The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment. Courts are not possessed of instruments of determination so delicate as to enable them to weigh the various factors in a complicated economic setting which, as to an isolated application of a State tax, might mitigate the obvious burden generally created by a direct tax on commerce.'

" *Id.,* at 663, 192 P.2d, at 978 (quoting *Freeman v. Hewit,* 329 U.S. 249, 256, 67 S.Ct. 274, 278, 91 L.Ed. 265 (1946)).

"[T]he situation obtaining in another state is immaterial. We must interpret the statute as passed by the legislature. In our opinion the statute marks a discrimination against interstate commerce in levying a tax upon wholesale activities of those engaged in interstate commerce, which tax is, because of the exemption contained in § 8370-6, not levied upon those who perform the same taxable act, but who manufacture in the state of Washington." *Id.,* at 664, 192 P.2d, at 979.

Two years later, in 1950, the Washington Legislature responded to this ruling by turning the B & O tax exemption scheme inside out. The legislature removed the wholesale tax exemption for local manufacturers and replaced it with an exemption from the manufacturing tax for the portion of manufacturers' output that is subject to the wholesale tax.[FN7] The result, as before 1950, is that local manufacturers pay the manufacturing tax on their interstate sales and out-of-state manufacturers pay the wholesale tax on their sales in Washington. Local manufacturer-wholesalers continue to ***237** pay only one gross receipts tax, but it is now applied to the activity of wholesaling rather than the activity of manufacturing. Although the tax rate has changed over the years-it is now forty-four hundredths of one percent, or 0.44%, of gross receipts-the relevant provisions of Washington's B & O tax are the same today as enacted in 1950.[FN8]

FN7. The Washington Supreme Court upheld this revised scheme against constitutional challenge in *B.F. Goodrich Co. v. State,* 38 Wash.2d 663, 231 P.2d 325, cert. denied, 342 U.S. 876, 72 S.Ct. 167, 96 L.Ed. 659 (1951).

FN8. The multiple activities exemption provides:

"(1) [E]very person engaged in activities which are within the purview of the provisions of two or more of sections RCW 82.04.230 to 82.04.290, inclusive, shall be taxable under each paragraph applicable to the activities engaged in.

"(2) Persons taxable under RCW 82.04.250 [tax on retailers] or 82.04.270 [tax on wholesalers and distributors] shall not be taxable under RCW 82.04.230 [tax on extractors], 82.04.240 [tax on manufacturers] or subsection (2), (3), (4), (5), or (7) of RCW 82.04.260 [tax on certain food processing activities] with respect to extracting or manufacturing of the products so sold.

"(3) Persons taxable under RCW 82.04.240 or RCW 82.04.260 subsection (4) shall not be taxable under RCW 82.04.230 with respect to extracting the ingredients of the products so manufactured." Wash.Rev.Code § 82.04.440 (1985).

The constitutionality of the B & O tax has been challenged on several occasions,[FN9] most strenuously in *General Motors Corp. v. Washington,* 377 U.S. 436, 84 S.Ct. 1564, 12 L.Ed.2d 430 (1964). In that case a bare majority of the Court upheld the tax; Justice****2815** BRENNAN and Justice Goldberg filed dissenting opinions. The bulk of the Court's opinion was devoted to rejecting the claims that the statute unconstitutionally taxed unapportioned gross receipts and did not bear a reasonable relation to the taxpayer's in-state activities. At the end of its opinion, the Court declined to reach the argument that the tax imposed multiple tax burdens on interstate transactions, because the taxpayer had failed to demonstrate "what definite ***238** burden, in a constitutional sense" other States' laws had placed on "the identical interstate shipments by which Washington measures its tax." *Id.,* at 449, 84 S.Ct., at 1572. Justice Goldberg, joined by Justice Stewart and Justice WHITE, dissented because

"[t]he burden on interstate commerce and the dangers of multiple taxation" were apparent from the face of the statute. *Id.,* at 459, 84 S.Ct., at 1577. FN10 Comparing the current statute ***239** with its invalid predecessor, this dissent concluded that the "amended provision would seem to have essentially the same economic effect on interstate sales but has the advantage of appearing nondiscriminatory." *Id.,* at 460, 84 S.Ct., at 1577. Today we squarely address the claim that this provision discriminates against interstate commerce.

FN9. See, *e.g., B.F. Goodrich Co. v. State, supra; General Motors Corp. v. Washington,* 377 U.S. 436, 84 S.Ct. 1564, 12 L.Ed.2d 430 (1964); *Standard Pressed Steel Co. v. Washington Dept. of Revenue,* 419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719 (1975); *Chicago Bridge & Iron Co. v. Washington Dept. of Revenue,* 98 Wash.2d 814, 659 P.2d 463, appeal dism'd, 464 U.S. 1013, 104 S.Ct. 542, 78 L.Ed.2d 718 (1983).

FN10. Justice Goldberg explained the functional equivalency for Commerce Clause purposes of the invalidated pre-1950 statute and its successor:

> "The burden on interstate commerce and the dangers of multiple taxation are made apparent by considering Washington's tax provisions. The Washington provision here involved-the 'tax on wholesalers'-provides that every person 'engaging within this state in the business of making sales at wholesale' shall pay a tax on such business 'equal to the gross proceeds of sales of such business multiplied by the rate of one-quarter of one per cent.' Rev.Code Wash. 82.04.270; Wash.Laws 1949, c. 228, § 1(e). In the same chapter Washington imposes a 'tax on manufacturers' which similarly provides that every person 'engaging within this state in business as a manufacturer' shall pay a tax on such business 'equal to the value of the products ... manufactured, multiplied by the rate of one-quarter of one per cent.' Rev.Code Wash. 82.04.240; Wash.Laws 1949, c. 228, § 1(b). Then in a provision entitled 'Persons taxable on multiple activities' the statute endeavors to insure that local Washington products will not be subjected both to the 'tax on manufacturers' and to the 'tax on wholesalers.' Rev.Code Wash. 82.04.440; Wash.Laws 1949, c. 228, § 2-A. Prior to its amendment in 1950 the exemptive terms of this 'multiple activities' provision were designed so that a Washington manufacturer-wholesaler would pay the manufacturing tax and be exempt from the wholesale tax. This provision, on its face, discriminated against interstate wholesale sales to Washington purchasers for it exempted the intrastate sales of locally made products while taxing the competing sales of interstate sellers. In 1950, however, the 'multiple activities' provision was amended, reversing the tax and the exemption, so that a Washington manufacturer-wholesaler would first be subjected to the wholesale tax and then, to the extent that he is taxed thereunder, exempted from the manufacturing tax. Rev.Code Wash. 82.04.440; Wash.Laws 1950 (special session), c. 5, § 2. See *McDonnell & McDonnell v. State,* 62 Wash.2d 553, 557, 383 P.2d 905, 908 (1963). This amended provision would seem to have essentially the same economic effect on interstate sales but has the advantage of appearing nondiscriminatory." *General Motors Corp. v. Washington,* 377 U.S., at 459-460, 84 S.Ct., at 1577 (dissenting opinion).

II

Two appeals are before us. In the first case (No. 85-2006), 71 commercial enterprises filed 53 separate actions for refunds of B & O taxes paid to the State. The Thurston County Superior Court joined the actions, found that the multiple activities exemption did not violate the Commerce Clause, and granted the State Department of Revenue's motion for summary judgment. In the second case (No. 85-1963), Tyler Pipe Industries, Inc. (Tyler), sought a refund of B & O taxes paid during the years 1976 through 1980 for its wholesaling activities in Washington. Again, the Superior Court upheld the B & O tax. The Washington Supreme Court affirmed in both cases. 105 Wash.2d 327, 732 P.2d 134 (1986); 105 Wash.2d 318, 715 P.2d 123 (1986).

The State Supreme Court concluded that the B & O tax was not facially discriminatory and rejected the appellants' arguments that our decision invalidating West Virginia's****2816** exemption for local wholesaler-manufacturers, *Armco Inc. v. Hardesty,* 467 U.S. 638, 104 S.Ct. 2620, 81 L.Ed.2d 540 (1984), required that the B & O tax be invalidated. The state court expressed the view that the West Virginia wholesale tax imposed on out-of-state manufacturers in *Armco* could not be justified as a compensating tax because of the substantial difference between the State's tax rates on manufacturing activities (.0088) and wholesaling activities (.0027), and because West Virginia did not provide for a reduction in its manufacturing tax when the manufactured goods were sold out of State, but did reduce the tax when the goods were partly manufactured out of State. The Washington Supreme Court then concluded that our requirement***240** that a tax must have " 'what might be called internal consistency-that is the [tax] must be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade," *Armco,* 467 U.S., at 644, 104 S.Ct., at 2623, was not dispositive because it merely relieved the taxpayer of the burden of proving that a tax already demonstrated to be facially discriminatory had in fact resulted in multiple taxation. The Washington Supreme Court also rejected the taxpayers' arguments that the B & O tax is not fairly apportioned to reflect the amount of business conducted in the State and is not fairly related to the services rendered by Washington.

We noted probable jurisdiction of the taxpayers' appeals, 479 U.S. 810, 107 S.Ct. 57, 93 L.Ed.2d 17 (1986), and now reverse in part and affirm in part. We first consider the claims of the taxpayers that have manufacturing facilities in Washington and market their products in other States; their challenge is directed to the fact that the manufacturing tax is levied only on those goods manufactured in Washington that are sold outside the State. We then consider Tyler's claims that its activities in the State of Washington are not sufficient to subject it to the State's taxing jurisdiction and that the B & O tax is not fairly apportioned.

III

[1] A person subject to Washington's wholesale tax for an item is not subject to the State's manufacturing tax for the same item. This statutory exemption for manufacturers that sell their products within the State has the same facially discriminatory consequences as the West Virginia exemption we invalidated in *Armco.* West Virginia imposed a gross receipts tax at the rate of 0.27% on persons engaged in the business of selling tangible property at wholesale. Local manufacturers were exempt from the tax, but paid a manufacturing tax of .88% on the value of products manufactured in the State. Even though local manufacturers bore a higher tax burden in dollars and cents, we held that their exemption from the wholesale tax violated the principle that "a State may not tax ***241** a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." 467 U.S., at 642, 104 S.Ct., at 2622.

In explaining why the tax was discriminatory on its face, we expressly endorsed the reasoning of Justice Goldberg's dissenting opinion in *General Motors Corp. v. Washington,* 377 U.S., at 459, 84 S.Ct., at 1577. We explained:

"The tax provides that two companies selling tangible property at wholesale in West Virginia will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it. Thus, if the property was manufactured in the State, no tax on the sale is imposed. If the property was manufactured out of the State and imported for sale, a tax of 0.27% is imposed on the sale price. See *General Motors Corp. v. Washington,* 377 U.S. 436, 459 [84 S.Ct. 1564, 1577, 12 L.Ed.2d 430] (1964) (Goldberg, J., dissenting) (similar provision in Washington, 'on its face, discriminated against interstate wholesale sales to Washington purchasers for it exempted ****2817** the intrastate sales of locally made products while taxing the competing sales of interstate sellers'); *Columbia Steel Co. v. State,* 30 Wash.2d 658, 664, 192 P.2d 976, 979 (1948) (invalidating Washington tax)." 467 U.S., at 642, 104 S.Ct., at 2622.

Our square reliance in *Armco* on Justice Goldberg's earlier dissenting opinion is especially significant because that dissent dooms appellee's efforts to limit the reasoning of *Armco* to the precise statutory structure at issue in that case. Justice Goldberg expressly rejected the distinction appellee attempts to draw between an exemption from a wholesaling tax-as was present in *Armco*-and the exemption from a manufacturing tax which was present in *General Motors* and is again present in these cases. See 377 U.S., at 459-460, 84 S.Ct., at 1577-1578. Our holding in *Armco* requires that we now agree with Justice Goldberg's conclusion that the exemption before us is the practical equivalent of the exemption that the Washington Supreme Court invalidated in 1948.

***242** *General Motors* is not a controlling precedent. As we have already noted, the result in that case did not depend on the Court's resolution of whether the tax burdened interstate commerce. Our reason for not passing on that question was that the taxpayer had "not demonstrated what definite burden, in a constitutional sense [the tax imposed by other States] places on the identical shipments by which Washington measures its tax." 377 U.S., at 449, 84 S.Ct., at 1572. Thus, when *General Motors* was decided, the Court required the taxpayer to prove that specific interstate transactions were subjected to multiple taxation in order to advance a claim of discrimination. See also *Standard Pressed Steel Co. v. Washington Revenue Dept.,* 419 U.S. 560, 563, 95 S.Ct. 706, 709, 42 L.Ed.2d 719 (1975) (rejecting Commerce Clause claim because taxpayer made no showing of risk of multiple taxation). In *Armco,* however, we categorically rejected this requirement. The facial unconstitutionality of Washington's gross receipts tax cannot be alleviated by examining the effect of legislation enacted by its sister States. See *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 276-278, 98 S.Ct. 2340, 2346-2347, 57 L.Ed.2d 197 (1978).[FN11]

FN11. In *Armco Inc. v. Hardesty,* 467 U.S. 638, 104 S.Ct. 2620, 81 L.Ed.2d 540 (1984), we quoted with approval the following sentence from the Court's opinion in *Freeman v. Hewit,* 329 U.S. 249, 256, 67 S.Ct. 274, 278, 91 L.Ed. 265 (1946):

"The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment." See 467 U.S., at 645, n. 8, 104 S.Ct., at 2624, n. 8.

The Washington Supreme Court also relied on *Freeman v. Hewit* in *Columbia Steel Co. v. State,* 30 Wash. 2d, at 663, 192 P.2d, at 978.

[2] We also reject the Department's contention that the State's imposition of the manufacturing tax on local goods sold outside the State should be saved as a valid "compensating tax." As we noted in *Maryland v. Louisiana,* 451 U.S. 725, 758, 101 S.Ct. 2114, 2135, 68 L.Ed.2d 576 (1981), the

"concept of a compensatory tax first requires identification of the burden for which the State is attempting to compensate." In these cases the only burdenfor *243 which the manufacturing tax exemption is arguably compensatory is the State's imposition of a wholesale tax on the local sales of local manufacturers; absent the exemption, a local manufacturer might be at an economic disadvantage because it would pay both a manufacturing and a wholesale tax, while the manufacturer from afar would pay only the wholesale tax. The State's justification for thus taxing the manufacture of goods in interstate commerce, however, fails under our precedents. The local sales of out-of-state manufacturers are also subject to Washington's wholesale tax, but the multiple activities exemption does not extend its ostensible compensatory benefit to those manufacturers. The exemption thus does not merely erase a tax incentive to engage in interstate**2818 commerce instead of intrastate commerce; it affirmatively places interstate commerce at a disadvantage.

"[T]he common theme running through the cases in which this Court has sustained compensating" taxes is "[e]qual treatment of interstate commerce." *Boston Stock Exchange v. State Tax Comm'n,* 429 U.S. 318, 331, 97 S.Ct. 599, 608, 50 L.Ed.2d 514 (1977) . See also *Maryland v. Louisiana,* 451 U.S., at 759, 101 S.Ct., at 2135. In *Boston Stock Exchange,* a New York transfer tax on securities transactions taxed transactions involving an out-of-state sale more heavily than other transactions involving an in-state sale. We invalidated the tax, rejecting the State's claim that it was compensatory legislation designed to neutralize the competitive advantage enjoyed by stock exchanges outside New York. We concluded:

> "Because of the delivery or transfer in New York, the seller cannot escape tax liability by selling out of State, but he can substantially reduce his liability by selling in State. The obvious effect of the tax is to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges. Rather than 'compensating' New York for a supposed competitive disadvantage resulting from § 270, the amendment forecloses tax-neutral decisions and creates both an advantage*244 for the exchanges in New York and a discriminatory burden on commerce to its sister States." 429 U.S., at 331, 97 S.Ct., at 607.

Similarly, in *Maryland v. Louisiana,* we held that a tax on the first use in Louisiana of gas brought into the State was not a "complement of a severance tax in the same amount imposed on gas produced within the State." *Armco,* 467 U.S., at 642-643, 104 S.Ct., at 2623, citing *Maryland v. Louisiana,* 451 U.S., at 758-759, 101 S.Ct., at 2135-2136. We relied on the observation that severance and first use were not "substantially equivalent" events on which mutually compensating taxes might be imposed. And in *Armco* we squarely held that manufacturing and wholesaling are not substantially equivalent activities. As we wrote in that case:

> "The gross sales tax imposed on Armco cannot be deemed a 'compensating tax' for the manufacturing tax imposed on its West Virginia competitors.... Here, too, manufacturing and wholesaling are not 'substantially equivalent events' such that the heavy tax on in-state manufacturers can be said to compensate for the admittedly lighter burden placed on wholesalers from out of State. Manufacturing frequently entails selling in the State, but we cannot say which portion of the manufacturing tax is attributable to manufacturing, and which portion to sales." 467 U.S., at 642-643, 104 S.Ct., at 2622-2623.

See also *Bacchus Imports, Ltd. v. Dias,* 468 U.S. 263, 272, 104 S.Ct. 3049, 3055, 82 L.Ed.2d 200 (1984). In light of the facially discriminatory nature of the multiple activities exemption, we conclude, as we did in *Armco,* that manufacturing and wholesaling are not "substantially equivalent events" such that taxing the manufacture of goods sold outside the State can be said to compensate for the State's inability to impose a wholesale tax on those goods. [FN12]

FN12. Nor may the tax be justified as an attempt to compensate the State for its inability to impose a similar burden on out-of-state manufacturers whose goods are sold in Washington, for Washington subjects those sales to wholesale tax.

***245** Appellee also contends that its B & O tax is valid because of its asserted similarities to a tax and exemption system we have upheld. The State assessed a use tax on personal property used within the State but originally purchased elsewhere to compensate for the burden that a sales tax placed on similar property purchased within the State. See *Henneford v. Silas Mason Co.,* 300 U.S. 577, 57 S.Ct. 524, 81 L.Ed. 814 (1937). Appellee's reliance on *Henneford v. Silas Mason Co.,* however, does not aid its cause. That case addressed a use tax ****2819** imposed by the State of Washington on the "privilege of using within this state any article of tangible personal property." The tax did not apply to "the use of any article of tangible personal property" the sale or use of which had already been taxed at an equal or greater rate under the laws of Washington or some other State. *Id.,* at 580-581, 57 S.Ct., at 525-526. We upheld the tax because, in the context of the overall tax structure, the burden it placed on goods purchased out-of-state was identical to that placed on an equivalent purchase within the State. This identical impact was no fortuity; it was guaranteed by the statutory exemption from the use tax for goods on which a sales tax had already been paid, [FN13] regardless of whether the sales tax had been paid to Washington or to another State. [FN14] ***246** As we explained in *Halliburton Oil Well Cementing Co. v. Reily,* 373 U.S. 64, 70, 83 S.Ct. 1201, 1204, 10 L.Ed.2d 202 (1963):

FN13. Many States provide tax credits that alleviate or eliminate the potential multiple taxation that results when two or more sovereigns have jurisdiction to tax parts of the same chain of commercial events. For example, the District of Columbia and all but three States with sales and use taxes provide a credit against their own use taxes for sales taxes paid to another State, although reciprocity may be required. See CCH State Tax Guide 6013-6014 (1986); *Williams v. Vermont,* 472 U.S. 14, 22, 105 S.Ct. 2465, 2471, 86 L.Ed.2d 11 (1985). See also *Halliburton Oil Well Cementing Co. v. Reily,* 373 U.S. 64, 74-75, 83 S.Ct. 1201, 1206-1207, 10 L.Ed.2d 202 (1963).

FN14. In his opinion for the Court in *Henneford v. Silas Mason Co.,* Justice Cardozo carefully described the relationship between the 2% "tax on retail sales" imposed by Title III of Washington's 1935 tax code and the "compensating tax" imposed by Title IV on the privilege of use. The compensating use tax was imposed on the use of an article of tangible personal property which had been purchased at retail but had not been subjected to a sales tax that was equal to or in excess of that imposed by the State of Washington. If the rate of the tax imposed by another jurisdiction was less than 2%, the rate of the compensating tax was measured by the difference. Explaining why such a compensating tax does not discriminate against interstate commerce, Justice Cardozo wrote:

"Equality is the theme that runs through all the sections of the statute. There shall be a tax upon the use, but subject to an offset if another use or sales tax has been paid for the same thing. This is true where the offsetting tax became payable to Washington by reason of purchase or use within the state. *It is true in exactly the same measure where the offsetting tax has been paid to another state by reason of use or purchase there.* No one who uses property in Washington after buying it at retail is to be exempt from a tax upon the privilege of enjoyment except to the extent that he has paid a use

> or sales tax somewhere. Every one who has paid a use or sales tax anywhere, or, more accurately, in any state, is to that extent to be exempt from the payment of another tax in Washington.
>
> "When the account is made up, the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates. The one pays upon one activity or incident, and the other upon another, but the sum is the same when the reckoning is closed." 300 U.S., at 583-584, 57 S.Ct., at 527 (emphasis added).

"The conclusion is inescapable: equal treatment for in-state and out-of-state taxpayers similarly situated is the condition precedent for a valid use tax on goods imported from out-of-state."

The parallel condition precedent for a valid multiple activities exemption eliminating exposure to the burden of a multiple tax on manufacturing and wholesaling would provide a credit against Washington tax liability for wholesale taxes paid by local manufacturers to any State, not just Washington. The multiple activities exemption only operates to impose a unified tax eliminating the risk of multiple taxation when the acts of manufacturing and wholesaling are both carried out within the State. The exemption excludes similarly situated manufacturers and wholesalers which conduct one of those activities within Washington and the other activity outside***247** the State. Washington's B & O tax scheme is therefore inconsistent with our precedents holding that a tax violates the Commerce Clause "when it unfairly burdens commerce by exacting more than a just share from the interstate activity." *Washington Dept. of Revenue v. Association of Washington Stevedoring Cos.,* 435 U.S. 734, 748, 98 S.Ct. 1388, 1393, 55 L.Ed.2d 682 (1978).

****2820** As we explained in *Armco,* our conclusion that a tax facially discriminates against interstate commerce need not be confirmed by an examination of the tax burdens imposed by other States:

> "Appellee suggests that we should require Armco to prove actual discriminatory impact on it by pointing to a State that imposes a manufacturing tax that results in a total burden higher than that imposed on Armco's competitors in West Virginia. This is not the test. In *Container Corp. of America v. Franchise Tax Board,* 463 U.S. 159, 169 [103 S.Ct. 2933, 2942, 77 L.Ed.2d 545] (1983), the Court noted that a tax must have 'what might be called internal consistency-that is the [tax] must be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade. In that case, the Court was discussing the requirement that a tax be fairly apportioned to reflect the business conducted in the State. A similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce. A tax that unfairly apportions income from other States is a form of discrimination against interstate commerce. See also *id.,* at 170-171 [103 S.Ct., at 2942-2943]. Any other rule would mean that the constitutionality of West Virginia's tax laws would depend on the shifting complexities of the tax codes of 49 other States, and that the validity of the taxes imposed on each taxpayer would depend on the particular other States in which it operated." 467 U.S., at 644-645, 104 S.Ct., at 2623 (footnote omitted).[FN15]
>
> FN15. Even the solitary dissenting opinion in the *Armco* case did not question the proposition that the constitutionality of the West Virginia tax could properly be discerned merely by referring to the text of the tax statute itself:
>
> "It is plain that West Virginia's tax would be unconstitutionally discriminatory if it levied no tax on manufacturing or taxed manufacturing at a lower rate than wholesaling, for then the out-

> of-state wholesaler would be paying a higher tax than the in-state manufacturer-wholesaler." 467 U.S., at 646, 104 S.Ct., at 2624 (REHNQUIST, J., dissenting).
>
> Instead, the dissent argued that West Virginia's taxing scheme, taken in its entirety, did not discriminate against out-of-state manufacturers because the manufacturing tax paid by a local manufacturer-wholesaler was much higher than the wholesale tax exacted from an out-of-state manufacturer.

***248** We conclude that Washington's multiple activities exemption discriminates against interstate commerce as did the tax struck down by the Washington Supreme Court in 1948 and the West Virginia tax that we invalidated in *Armco.* The current B & O tax exposes manufacturing or selling activity outside the State to a multiple burden from which only the activity of manufacturing in-state and selling in-state is exempt. The fact that the B & O tax "has the advantage of appearing nondiscriminatory," see *General Motors Corp.,* 377 U.S., at 460, 84 S.Ct., at 1577 (Goldberg, J., dissenting), does not save it from invalidation. To the extent that this conclusion is inconsistent with the Court's ruling in the *General Motors* case, that case is overruled. [FN16]

> FN16. In view of our holding on the discrimination issue, we need not reach the claim of local state manufacturers selling to interstate markets that the tax scheme does not fairly apportion tax liabilities between Washington and other States.

IV

Our holding that Washington's tax exemption for a local manufacturer-wholesaler violates the Commerce Clause disposes of the issues raised by those appellants in *National Can* that manufacture goods in Washington and sell them outside the State, as well as the claim of discrimination asserted by those appellants that manufacture goods outside Washington and sell them within the State. Compliance ***249** with our holding on the discrimination issue, however, would not necessarily preclude the continued assessment of a wholesaling tax. Either a repeal of the manufacturing tax or an expansion of the multiple activities exemption to provide out-of-state manufacturers****2821** with a credit for manufacturing taxes paid to other States would presumably cure the discrimination. We must therefore also consider the alternative challenge to the wholesale tax advanced by Tyler and the other appellants that manufacture products outside of Washington for sale in the State.

Tyler seeks a refund of wholesale taxes it paid on sales to customers in Washington for the period from January 1, 1976, through September 30, 1980. These products were manufactured outside of Washington. Tyler argues that its business does not have a sufficient nexus with the State of Washington to justify the collection of a gross receipts tax on its sales. Tyler sells a large volume of cast iron, pressure and plastic pipe and fittings, and drainage products in Washington, but all of those products are manufactured in other States. Tyler maintains no office, owns no property, and has no employees residing in the State of Washington. Its solicitation of business in Washington is directed by executives who maintain their offices out-of-state and by an independent contractor located in Seattle.

The trial court found that the in-state sales representative engaged in substantial activities that helped Tyler to establish and maintain its market in Washington. The State Supreme Court concluded that those findings were supported by the evidence, and summarized them as follows:

> "The sales representatives acted daily on behalf of Tyler Pipe in calling on its customers and soliciting orders. They have long-established and valuable relationships with Tyler Pipe's customers. Through sales contacts, the representatives

maintain and improve the name recognition, market share, goodwill, and individual customer relations of Tyler Pipe.

***250** "Tyler Pipe sells in a very competitive market in Washington. The sales representatives provide Tyler Pipe with virtually all their information regarding the Washington market, including: product performance; competing products; pricing, market conditions and trends; existing and upcoming construction products; customer financial liability; and other critical information of a local nature concerning Tyler Pipe's Washington market. The sales representatives in Washington have helped Tyler Pipe and have a special relationship to that corporation. The activities of Tyler Pipe's agents in Washington have been substantial." 105 Wash.2d, at 325, 715 P.2d, at 127.

[3] As a matter of law, the Washington Supreme Court concluded that this showing of a sufficient nexus could not be defeated by the argument that the taxpayer's representative was properly characterized as an independent contractor instead of as an agent. We agree with this analysis. In *Scripto, Inc. v. Carson,* 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960), Scripto, a Georgia corporation, had no office or regular employees in Florida, but it employed wholesalers or jobbers to solicit sales of its products in Florida. We held that Florida may require these solicitors to collect a use tax from Florida customers. Although the "salesmen" were not employees of Scripto, we determined that "such a fine distinction is without constitutional significance." *Id.,* at 211, 80 S.Ct., at 621. This conclusion is consistent with our more recent cases. See *National Geographic Society v. California Equalization Board,* 430 U.S. 551, 556-558, 97 S.Ct. 1386, 1390-1391, 51 L.Ed.2d 631 (1977).

[4] As the Washington Supreme Court determined, "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." 105 Wash.2d, at 323, 715 P.2d, at 126. The court found this standard was ***251** satisfied because Tyler's "sales representatives perform any local activities necessary for maintenance of Tyler Pipe's market and protection of its interests...." *Id.,* at 321, 715 P.2d, at 125. ****2822** We agree that the activities of Tyler's sales representatives adequately support the State's jurisdiction to impose its wholesale tax on Tyler.

[5] Tyler also asserts that the B & O tax does not fairly apportion the tax burden between its activities in Washington and its activities in other States. See *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 285, 97 S.Ct. 1076, 1082, 51 L.Ed.2d 326 (1977). Washington taxes the full value of receipts from in-state wholesaling or manufacturing; thus, an out-of-state manufacturer selling in Washington is subject to an unapportioned wholesale tax even though the value of the wholesale transaction is partly attributable to manufacturing activity carried on in another State that plainly has jurisdiction to tax that activity. This apportionment argument rests on the erroneous assumption that through the B & O tax, Washington is taxing the unitary activity of manufacturing and wholesaling. We have already determined, however, that the manufacturing tax and wholesaling tax are not compensating taxes for substantially equivalent events in invalidating the multiple activities exemption. Thus, the activity of wholesaling-whether by an in-state or an out-of-state manufacturer-must be viewed as a separate activity conducted wholly within Washington that no other State has jurisdiction to tax. See *Moorman Mfg. Co. v. Bair,* 437 U.S., at 280-281, 98 S.Ct., at 2348-2349 (gross receipts tax on sales to customers within State would be "plainly valid"); *Standard Pressed Steel Co. v. Washington Revenue Dept.,* 419 U.S., at 564, 95 S.Ct., at 709 (selling tax measured by gross proceeds of sales is "apportioned exactly to the activities taxed").

V

[6] The Department of Revenue argues that any adverse decision in these cases should not be applied

retroactively because the taxes at issue were assessed prior to our opinion in *252 *Armco* and the holding in that case was not clearly foreshadowed by earlier opinions. See *Chevron Oil Co. v. Huson,* 404 U.S. 97, 106-107, 92 S.Ct. 349, 355-356, 30 L.Ed.2d 296 (1971) (factors to consider in deciding whether to impose decision prospectively only). The State's argument is similar to an argument advanced by the State of Hawaii in *Bacchus Imports, Ltd. v. Dias,* 468 U.S., at 276-277, 104 S.Ct., at 3058. The State urged that, if we invalidated the tax at issue, we should not require the payment of refunds to taxpayers. We did not resolve the merits of that issue, concluding that this Court should not take it upon itself in this complex area of state tax structures to determine how to apply its holding:

> "These refund issues, which are essentially issues of remedy for the imposition of a tax that unconstitutionally discriminated against interstate commerce, were not addressed by the state courts. Also, the federal constitutional issues involved may well be intertwined with, or their consideration obviated by, issues of state law. Also, resolution of those issues, if required at all, may necessitate more of a record than so far has been made in this case. We are reluctant, therefore, to address them in the first instance. Accordingly, we reverse the judgment of the Supreme Court of Hawaii and remand for further proceedings not inconsistent with this opinion." *Id.,* at 277, 104 S.Ct., at 3058 (footnote omitted).

We followed this approach in *Williams v. Vermont,* 472 U.S. 14, 105 S.Ct. 2465, 86 L.Ed.2d 11 (1985), an opinion which invalidated the State's residency restriction on the availability of a sales tax credit for use tax paid to another State. We expressed no opinion on the appropriate remedy, instead remanding to the Supreme Court of Vermont "in light of the fact that the action was dismissed on the pleadings, and given the possible relevance of state law, see *Bacchus Imports, Ltd. v. Dias,* 468 U.S. 263, 277 [104 S.Ct. 3049, 3058, 82 L.Ed.2d 200] (1984) ...." *Id.,* at 28, 105 S.Ct. 2474. Cf. **2823*Hooper v. Bernalillo County Assessor,* 472 U.S. 612, 622-623, 105 S.Ct. 2862, 2868, 86 L.Ed.2d 487 (1985). We conclude*253 that it is likewise appropriate for the Supreme Court of Washington to address in the first instance the refund issues raised by our rulings in these cases.

VI

We hold Washington's multiple activities exemption invalid because it places a tax burden upon manufacturers in Washington engaged in interstate commerce from which local manufacturers selling locally are exempt. We reject appellant Tyler's nexus and fair apportionment challenges to the State's wholesale tax. Our partial invalidation of the State's taxing scheme raises remedial issues that are better addressed by the State Supreme Court on remand. Accordingly, we vacate the judgments of the Supreme Court of Washington and remand for further proceedings not inconsistent with this opinion.

It is so ordered.

Justice POWELL took no part in the consideration or decision of these cases.Justice O'CONNOR, concurring.

I join the Court's opinion holding that "[i]n light of the facially discriminatory nature of the multiple activities exemption," *ante,* at 2818, see *Maryland v. Louisiana,* 451 U.S. 725, 756-757, 101 S.Ct. 2114, 2134-2135, 68 L.Ed.2d 576 (1981), the Washington taxpayers need not prove actual discriminatory impact "by an examination of the tax burdens imposed by other States." *Ante,* at 2820. I do not read the Court's decision as extending the "internal consistency" test described in *Armco Inc. v. Hardesty,* 467 U.S. 638, 644-645, 104 S.Ct. 2620, 2623-2624, 81 L.Ed.2d 540 (1984), to taxes that are not facially discriminatory, contra, *post,* at 2825 (SCALIA, J., concurring in part and dissenting in part), nor would I agree with such a result in these cases. See *American Trucking Assns., Inc. v. Scheiner,* 483 U.S. 266, 298, 107 S.Ct. 2829, 2848, 97 L.Ed.2d 226 (1987) (O'CONNOR, J., dissent-

ing).

***254** Justice SCALIA, with whom THE CHIEF JUSTICE joins in Part I, concurring in part and dissenting in part.

I join Part IV of the Court's opinion, upholding Washington's unapportioned wholesale tax and rejecting Tyler Pipe's claim that it did not have a sufficient nexus with Washington to give the State taxing jurisdiction. I dissent, however, from the remainder of the opinion, invalidating the State's manufacturing tax as unconstitutionally discriminatory under the Commerce Clause. The standard for discrimination adopted by the Court, which drastically limits the States' discretion to structure their tax systems, has no basis in the Constitution, and is not required by our past decisions.

I

Implicitly in these cases, *ante,* at 2819-2821, and explicitly in *American Trucking Assns., Inc. v. Scheiner,* 483 U.S. 266, 284, 107 S.Ct. 2829, 2481, 97 L.Ed.2d 226 (1987), the Court imposes on state taxes a requirement of "internal consistency," demanding that they " 'be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade." *Armco Inc. v. Hardesty,* 467 U.S. 638, 644, 104 S.Ct. 2620, 2623, 81 L.Ed.2d 540 (1984) (quoting *Container Corp. of America v. Franchise Tax Board,* 463 U.S. 159, 169, 103 S.Ct. 2933, 2942, 77 L.Ed.2d 545 (1983)). [FN1] It is clear, for the reasons given by the Court, *ante,* at 2819-2820, that the Washington business and occupation (B & O) tax fails that test. So would any unapportioned flat tax on multistate activities, such as the axle tax or marker fee at issue ****2824** in *Scheiner,* 483 U.S. 266, 107 S.Ct. 2829, 97 L.Ed.2d 226. It is equally clear to me, however, that this internal consistency principle is nowhere to be found in the Constitution. Nor is it plainly required by our prior decisions. Indeed, in order to apply the internal consistency ***255** rule in this case, the Court is compelled to overrule a rather lengthy list of prior decisions, from *Hinson v. Lott,* 8 Wall. 148, 19 L.Ed. 387 (1869), to *General Motors Corp. v. Washington,* 377 U.S. 436, 84 S.Ct. 1564, 12 L.Ed.2d 430 (1964), and including, as is made explicit in *Scheiner,* 483 U.S. 266, 107 S.Ct. 2829, 97 L.Ed.2d 226, *Capitol Greyhound Lines v. Brice,* 339 U.S. 542, 70 S.Ct. 806, 94 L.Ed. 1053 (1950), *Aero Mayflower Transit Co. v. Board of Railroad Comm'rs,* 332 U.S. 495, 68 S.Ct. 167, 92 L.Ed. 99 (1947), and *Aero Mayflower Transit Co. v. Georgia Public Service Comm'n,* 295 U.S. 285, 55 S.Ct. 709, 79 L.Ed. 1439 (1935). Moreover, the Court must implicitly repudiate the approval given in dicta 10 years ago to New York's pre-1968 transfer tax on securities. See *Boston Stock Exchange v. State Tax Comm'n,* 429 U.S. 318, 330, 97 S.Ct. 599, 607, 50 L.Ed.2d 514 (1977).[FN2] Finally, we noted only two Terms ago-and one Term after *Armco, supra,* was decided-that we had never held that "a State must credit a sales tax paid to another State against its own use tax." *Williams v. Vermont,* 472 U.S. 14, 21-22, 105 S.Ct. 2465, 2471, 86 L.Ed.2d 11 (1985). See *Southern Pacific Co. v. Gallagher,* 306 U.S. 167, 172, 59 S.Ct. 389, 391, 83 L.Ed. 586 (1939). If we had applied an internal consistency rule at that time, the need for such a credit would have followed as a matter of mathematical necessity. The Court's presumed basis for creating this rule now, 198 years after adoption of the Constitution, is that the reasoning of *Armco* requires it. See *Scheiner,* 483 U.S., at 284, 107 S.Ct., at 2840. In my view, however, that reasoning was dictum, which we should explicitly reject. And if one insists on viewing it as holding, and thus ***256** as conflicting with decades of precedents upholding internally inconsistent state taxes, it seems to me that *Armco* rather than those numerous other precedents ought to be overruled.

FN1. The majority finds Washington's manufacturing tax exemption for local wholesalers discriminatory because it "excludes similarly situated manufacturers and wholesalers which conduct one of those activities within Washington and the other activity outside the State." *Ante,* at 2820. That exclusion, however, can only

be deemed *facially* discriminatory if one assumes that every State's taxing scheme is identical to Washington's.

FN2. The New York statute taxed, *inter alia,* both the sale and delivery of securities if either event occurred in New York, 429 U.S., at 321, 97 S.Ct., at 603, but imposed only one tax if both events occurred in that State. While the Court invalidated as discriminatory an amendment to that law reducing the tax for in-state sales by nonresidents and placing a cap on the tax payable on transactions involving in-state sales, it also declared that the statute prior to the amendment "was neutral as to in-state and out-of-state sales." *Id.,* at 330, 97 S.Ct., at 607. That is plainly not true if internal consistency is a requirement of neutrality: assuming that all States had New York's pre-1968 scheme, if sale and delivery both took place in New York, there would be a single tax, while if sale took place in New York and delivery in New Jersey, there would be double taxation.

Prior to *Armco,* the internal consistency test was applied only in cases involving apportionment of the net income of businesses that more than one State sought to tax. That was the issue in *Container Corp.,* see 463 U.S., at 169-171, 103 S.Ct., at 2942-2943, the only case cited by *Armco* in support of an internal consistency rule, see 467 U.S., at 644-645, 104 S.Ct., at 2623-2624, and there is no reason automatically to require internal consistency in other contexts. A business can of course earn net income in more than one State, but the total amount of income is a unitary figure. Hence, when more than one State has taxing jurisdiction over a multistate enterprise, an inconsistent apportionment scheme could result in taxation of more than 100% of that firm's net income. Where, however, tax is assessed not on unitary income but on discrete events such as sale, manufacture, and delivery, which can occur in a single State or in different States, that apportionment principle is not applicable; there is simply no unitary figure or event to apportion. That we have not traditionally applied the internal consistency test outside the apportionment context is amply demonstrated by the lengthy list of cases that the Court has **2825 (openly or tacitly) had to overrule here and in *Scheiner.*

It is possible to read *Armco* as requiring such a test in all contexts, but it is assuredly not necessary to do so. *Armco* dealt with West Virginia's 0.27% selling tax and 0.88% manufacturing tax, and its exemption from the selling tax for in-state but not out-of-state manufacturers. We discussed the internal consistency of that taxing scheme only after finding the selling tax discriminatory "[o]n its face," 467 U.S., at 642, 104 S.Ct., at 2622, because "[t]he tax provides that two companies selling tangible property at wholesale in West Virginia will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it." *Ibid.* Combined with the finding that the selling tax imposed on *257 out-of-state producers could not be deemed to "compensate" for the higher manufacturing tax imposed only on West Virginia producer/sellers, *id.,* at 642-643, 104 S.Ct., at 2622-2623, that was enough to invalidate the tax. We went on to address the internal consistency rule in response to the State's argument that the taxpayer had not shown "actual discriminatory impact on it by pointing to a State that imposes a manufacturing tax that results in a total burden higher than that imposed on Armco's competitors in West Virginia." *Id.,* at 644, 104 S.Ct., at 2623. After reciting the internal consistency principle applicable in apportionment cases, we said that "[a] similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce," *ibid.,* 104 S.Ct., at 2623-2624, regardless of "the shifting complexities of the tax codes of 49 other States...." *Id.,* at 645, 104 S.Ct., at 2624. The holding of *Armco* thus establishes only that a facially discriminatory taxing scheme that is not internally consistent will not be saved by the claim that in fact no adverse impact on interstate commerce has occurred.

To expand that brief discussion into a holding that internal consistency is always required, and thereby to revolutionize the law of state taxation, is remarkable.

Rather than use isolated language, written with no evident consideration of its potential significance if adopted as a general rule, to overturn a lengthy list of settled decisions, one would think that we would instead use the settled decisions to limit the scope of the isolated language. As the cases from the past few Terms indicate, the internal consistency test invalidates a host of taxing methods long relied upon by the States and left unhampered by Congress. We are already on shaky ground when we invoke the Commerce Clause as a self-operative check on state legislation, see Part II, *infra,* requiring us to develop rules unconstrained by the text of the Constitution. Prudence counsels in favor of the least intrusive rule possible.

Applying more traditional tests, the Washington B & O tax is valid. It is not facially discriminatory. Unlike the ***258** West Virginia tax in *Armco,* Washington's selling tax is imposed on all goods, whether produced in-state or out-of-state. No manufacturing tax is (or could be) imposed on out-of-state manufacturers, so no discrimination is present (or possible) there. All the State does is to relieve local producer/sellers from the burden of double taxation by declining to assess a manufacturing tax on local businesses with respect to goods on which a selling tax is paid. Nor does this arrangement, notwithstanding its nondiscriminatory appearance, have discriminatory effects in and of itself. An in-state manufacturer selling in-state pays one tax to Washington; an in-state manufacturer selling out-of-state pays one tax to Washington; and an out-of-state manufacturer selling in-state pays one tax to Washington. The State collects the same tax whether interstate or intrastate commerce is involved. The tax can be considered to have discriminatory effects only if one consults what other States are in fact doing (a case-by-case inquiry that appeals to no one, *ante,* at ----) or unless one adopts an assumption as to what other States are ****2826** doing. It is the latter course that the internal consistency rule adopts, assuming for purposes of our Commerce Clause determination that other States have the same tax as the tax under scrutiny. As noted earlier, I see no basis for that assumption in the tradition of our cases; and I see little basis for it in logic as well. Specifically, I see no reason why the fact that other States, by adopting a *similar* tax, might cause Washington's tax to have a discriminatory effect on interstate commerce, is of any more significance than the fact that other States, by adopting a *dissimilar* tax, might produce such a result. The latter, of course, does not suffice to invalidate a tax. To take the simplest example: A tax on manufacturing (without a tax on wholesaling) will have a discriminatory effect upon interstate commerce if another State adopts a tax on wholesaling (without a tax on manufacturing)-for then a company manufacturing and selling in the former State would pay only a single tax, while a company ***259** manufacturing in the former State but selling in the latter State would pay two taxes. When this very objection was raised in *Armco,* we replied that, unlike the situation in *Armco* itself, "such a result would not arise from impermissible discrimination against interstate commerce...." 467 U.S., at 645, 104 S.Ct., at 2624. That response was possible there because the West Virginia tax was facially discriminatory; it is not possible here because the Washington B & O tax is not.

It seems to me that we should adhere to our long tradition of judging state taxes on their own terms, and that there is even less justification for striking them down on the basis of assumptions as to what other States *might* do than there is for striking them down on the basis of what other States *in fact* do. Washington's B & O tax is plainly lawful on its own. It may well be that other States will impose similar taxes that will increase the burden on businesses operating interstate-just as it may well be that they will impose *dis*similar taxes that have the same effect. That is why the Framers gave Congress the power to regulate interstate commerce.

Evaluating each State's taxing scheme on its own gives this Court the power to eliminate evident discrimination, while at the same time leaving the States an appropriate degree of freedom to structure their revenue measures. Finer tuning than this is for the Congress.

II

I think it particularly inappropriate to leap to a restrictive "internal consistency" rule, since the platform from which we launch that leap is such an unstable structure. It takes no more than our opinions this Term, and the number of prior decisions they explicitly or implicitly overrule, to demonstrate that the practical results we have educed from the so-called "negative" Commerce Clause form not a rock but a "quagmire," *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959). Nor is this a recent liquefaction. The fact is that in the 114 years since ***260** the doctrine of the negative Commerce Clause was formally adopted as holding of this Court, see *Case of the State Freight Tax,* 15 Wall. 232, 21 L.Ed. 146 (1873), and in the 50 years prior to that in which it was alluded to in various dicta of the Court, see *Cooley v. Board of Wardens,* 12 How. 299, 319, 13 L.Ed. 996 (1852); *Gibbons v. Ogden,* 9 Wheat. 1, 209, 6 L.Ed. 23 (1824); *id.,* at 226-229, 235-239 (Johnson, J., concurring in judgment), our applications of the doctrine have, not to put too fine a point on the matter, made no sense. See generally D. Currie, The Constitution in the Supreme Court: The First Hundred Years 1789-1888, pp. 168-181, 222-236, 330-342, 403-416 (1985). [FN3]

> FN3. Professor Currie's discussion of the Commerce Clause decisions of the Marshall and Taney Courts is summed up by his assessment of the leading Taney Court decision: "Taken by itself, *Cooley [v. Board of Wardens,* 12 How. 299, 13 L.Ed. 996 (1852),] may appear arbitrary, conclusory, and irreconcilable with the constitutional text. Nevertheless, anyone who has slogged through the Augean agglomeration preceding Curtis's labors must find them scarcely less impressive than those of the old stable-cleaner himself." D. Currie, The Constitution in the Supreme Court: The First Hundred Years 1789-1888, p. 234 (1985). He concludes his discussion of the Chase Court's Commerce Clause jurisprudence by noting: "In doctrinal terms the Court's efforts in this field can be described only as a disaster." *Id.,* at 342 (footnote omitted). And the Waite Court receives the following testimonial: "It is a relief that with the *Bowman* decision [*Bowman v. Chicago & Northwestern R. Co.,* 125 U.S. 465, 8 S.Ct. 689, 31 L.Ed. 700 (1888),] we have reached the end of the commerce clause decisions of the Waite period, for they do not make elevating reading." *Id.,* at 416 (footnote omitted). Future commentators are not likely to treat recent eras much more tenderly.

****2827** That uncertainty in application has been attributable in no small part to the lack of any clear theoretical underpinning for judicial "enforcement" of the Commerce Clause. The text of the Clause states that "Congress shall have Power ... To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Art. I, § 8, cl. 3. On its face, this is a charter for Congress, not the courts, to ensure "an area of trade free from interference by the States." *Boston Stock Exchange,* 429 U.S., at 328, 97 S.Ct., at 606. The pre-emption of state legislation would automatically follow,***261** of course, if the grant of power to Congress to regulate interstate commerce were exclusive, as Charles Pinckney's draft constitution would have provided, see Abel, The Commerce Clause in the Constitutional Convention and in Contemporary Comment, 25 Minn.L.Rev. 432, 434 (1941), and as John Marshall at one point seemed to believe it was. See *Gibbons v. Ogden, supra,* at 209. However, unlike the District Clause, which

empowers Congress "To exercise exclusive Legislation," Art. I, § 8, cl. 17, the language of the Commerce Clause gives no indication of exclusivity. See *License Cases,* 5 How. 504, 579, 12 L.Ed. 256 (1847) (opinion of Taney, C.J.). Nor can one assume generally that Congress' Article I powers are exclusive; many of them plainly coexist with concurrent authority in the States. See *Kewanee Oil Co. v. Bicron Corp.,* 416 U.S. 470, 479, 94 S.Ct. 1879, 1885, 40 L.Ed.2d 315 (1974) (patent power); *Goldstein v. California,* 412 U.S. 546, 560, 93 S.Ct. 2303, 2311, 37 L.Ed.2d 163 (1973) (copyright power); *Houston v. Moore,* 5 Wheat. 1, 25, 5 L.Ed. 19 (1820) (court-martial jurisdiction over the militia); *Sturges v. Crowninshield,* 4 Wheat. 122, 193-196, 4 L.Ed. 529 (1819) (bankruptcy power). Furthermore, there is no correlative denial of power over commerce to the States in Art. I, § 10, as there is, for example, with the power to coin money or make treaties. And both the States and Congress assumed from the date of ratification that at least some state laws regulating commerce were valid. See *License Cases, supra,* at 580-581. The exclusivity rationale is infinitely less attractive today than it was in 1847. Now that we know interstate commerce embraces such activities as growing wheat for home consumption, *Wickard v. Filburn,* 317 U.S. 111, 63 S.Ct. 82, 87 L.Ed. 122 (1942), and local loan sharking, *Perez v. United States,* 402 U.S. 146, 91 S.Ct. 1357, 28 L.Ed.2d 686 (1971), it is more difficult to imagine what state activity would survive an exclusive Commerce Clause than to imagine what would be precluded.

Another approach to theoretical justification for judicial enforcement of the Commerce Clause is to assert, as did Justice Curtis in dicta in *Cooley v. Board of Wardens, supra,* at 319, that "[w]hatever subjects of this power are in their ***262** nature national, or admit only of one uniform system, or plan of regulation, may justly be said to be of such a nature as to require exclusive legislation by Congress." That would perhaps be a wise rule to adopt (though it is hard to see why judges rather than legislators are fit to determine what areas of commerce "in their nature" require national regulation), but it has the misfortune of finding no conceivable basis in the text of the Commerce Clause, which treats "Commerce ... among the several States" as a unitary subject. And attempting to limit the Clause's pre-emptive effect ****2828** to state laws *intended* to regulate commerce (as opposed to those intended, for example, to promote health), see *Gibbons v. Ogden, supra,* at 203, while perhaps a textually possible construction of the phrase "regulate Commerce," is a most unlikely one. Distinguishing between laws with the *purpose* of regulating commerce and "police power" statutes with that *effect* is, as Taney demonstrated in the *License Cases, supra,* at 582-583, more interesting as a metaphysical exercise than useful as a practical technique for marking out the powers of separate sovereigns.

The least plausible theoretical justification of all is the idea that in enforcing the negative Commerce Clause the Court is not applying a constitutional command at all, but is merely interpreting the will of Congress, whose silence in certain fields of interstate commerce (but not in others) is to be taken as a prohibition of regulation. There is no conceivable reason why congressional inaction under the Commerce Clause should be deemed to have the same pre-emptive effect elsewhere accorded only to congressional action. There, as elsewhere, "Congress' silence is just that-silence...." *Alaska Airlines, Inc. v. Brock,* 480 U.S. 678, 686, 107 S.Ct. 1476, 1481, 94 L.Ed.2d 661 (1987). See Currie, *supra* n. 3, at 334 (noting "the recurring fallacy that in some undefined cases congressional inaction was to be treated as if it were permissive or prohibitory legislation-though ***263** the Constitution makes clear that Congress can act only by affirmative vote of both Houses" (footnotes omitted)).[FN4]

> FN4. Unfortunately, this "legislation by inaction" theory of the negative Commerce Clause seems to be the only basis for the doctrine, relied upon by the Court in *Scheiner,* 483 U.S., at 289, n. 23, 107 S.Ct., at 2843, n. 23, that Congress can au-

> thorize States to enact legislation that would otherwise violate the negative Commerce Clause. See *Prudential Ins. Co. v. Benjamin,* 328 U.S. 408, 66 S.Ct. 1142, 90 L.Ed. 1342 (1946). Nothing else could explain the *Benjamin* principle that what was invalid state action can be rendered valid state action through "congressional consent." There is surely no area in which Congress can permit the States to violate the Constitution. Thus, in *Cooley v. Board of Wardens,* 12 How. 299, 13 L.Ed. 996 (1852), Justice Curtis, to whom there had not occurred the theory of congressional legislation by inaction, wrote of the relationship between States and the negative Commerce Clause as follows: "If the States were divested of the power to legislate on this subject by the grant of the commercial power to Congress, it is plain this Act could not confer upon them power thus to legislate. If the Constitution excluded the States from making any law regulating commerce, certainly Congress cannot regrant, or in any manner reconvey to the States that power." *Id.,* at 318.

The historical record provides no grounds for reading the Commerce Clause to be other than what it says-an authorization for Congress to regulate commerce. The strongest evidence in favor of a negative Commerce Clause-that version of it which renders federal authority over interstate commerce exclusive-is Madison's comment during the Convention: "Whether the States are now restrained from laying tonnage duties depends on the extent of the power 'to regulate commerce.' These terms are vague but seem to exclude this power of the States." 2 M. Farrand, Records of the Federal Convention of 1787, p. 625 (1937). This comment, however, came during discussion of what became Art. I, § 10, cl. 3: "No State shall, without the Consent of Congress, lay any Duty of Tonnage...." The fact that it is difficult to conceive how the power to regulate commerce would *not* include the power to impose duties; and the fact that, despite this apparent coverage, the Convention went on to adopt a provision prohibiting States from levying duties on tonnage without congressional approval; suggest that Madison's assumption*264 of exclusivity of the federal commerce power was ill considered and not generally shared.

Against this mere shadow of historical support there is the overwhelming reality that the Commerce Clause, in its broad outlines, was not a major subject of controversy, neither during the constitutional debates nor in the ratifying conventions. Instead,**2829 there was "nearly universal agreement that the federal government should be given the power of regulating commerce," Abel, 25 Minn.L.Rev., at 443-444, in much the form provided. "The records disclose no constructive criticisms by the states of the commerce clause as proposed to them." F. Frankfurter, The Commerce Clause under Marshall, Taney and Waite 12 (1937). In The Federalist, Madison and Hamilton wrote numerous discourses on the virtues of free trade and the need for uniformity and national control of commercial regulation, see The Federalist No. 7, pp. 62-63 (C. Rossiter ed. 1961); *id.,* No. 11, pp. 89-90; *id.,* No. 22, pp. 143-145; *id.,* No. 42, pp. 267-269; *id.,* No. 53, p. 333, but said little of substance specifically about the Commerce Clause-and that little was addressed primarily to foreign and Indian trade. See generally Abel, *supra,* at 470-474. Madison does not seem to have exaggerated when he described the Commerce Clause as an addition to the powers of the National Government "which few oppose and from which no apprehensions are entertained." The Federalist No. 45, p. 293. I think it beyond question that many "apprehensions" would have been "entertained" if supporters of the Constitution had hinted that the Commerce Clause, despite its language, gave this Court the power it has since assumed. As Justice Frankfurter pungently put it: "the doctrine that state authority must be subject to such limitations as the Court finds it necessary to apply for the protection of the national community ... [is] an audacious doctrine, which,

one may be sure, would hardly have been publicly avowed in support of the adoption of the Constitution." Frankfurter, *supra,* at 19.

***265** In sum, to the extent that we have gone beyond guarding against rank discrimination against citizens of other States-which is regulated not by the Commerce Clause but by the Privileges and Immunities Clause, U.S. Const., Art. IV, § 2, cl. 1 ("The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States")-the Court for over a century has engaged in an enterprise that it has been unable to justify by textual support or even coherent nontextual theory, that it was almost certainly not intended to undertake, and that it has not undertaken very well. It is astonishing that we should be expanding our beachhead in this impoverished territory, rather than being satisfied with what we have already acquired by a sort of intellectual adverse possession.

U.S.Wash.,1987.
Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue
483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199, 55 USLW 4978

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95 S.Ct. 706
419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719
(Cite as: 419 U.S. 560, 95 S.Ct. 706)

Supreme Court of the United States
STANDARD PRESSED STEEL CO., Appellant,
v.
State of WASHINGTON DEPARTMENT OF REVENUE.
No. 73-1697.

Argued Dec. 16, 1974.
Decided Jan. 22, 1975.

Manufacturer of aerospace fasteners, with a home office and manufacturing plant in Pennsylvania and another plant in California, brought suit challenging the constitutionality of Washington State's business and occupation tax which was levied on the unapportioned gross receipts of the manufacturer resulting from its sale of aerospace fasteners to Washington aerospace company. The state taxing authorities found that the manufacturer's business activities in Washington were sufficient to sustain the tax, and that decision was affirmed by the Court of Appeals of Washington, Division II, 10 Wash.App. 45, 516 P.2d 1043, and the Supreme Court of Washington denied review. Upon appeal, the Supreme Court, Mr. Justice Douglas, held that (1) imposition of the tax was not violative of due process, as the measure of the tax bore a relationship to the benefits conferred on the manufacturer by the State, and (2) the tax was not repugnant to the commerce clause, as the manufacturer made no showing of multiple taxation on its interstate business and as the tax was apportioned exactly to the activities taxed, all of which were intrastate.

Affirmed.

West Headnotes

[1] Constitutional Law 92 ⇐4146

92 Constitutional Law
92XXVII Due Process
92XXVII(G) Particular Issues and Applications
92XXVII(G)6 Taxation
92k4146 k. Gross Receipts Taxes. Most Cited Cases
(Formerly 92k287.2(2), 92k283)

Licenses 238 ⇐7(1)

238 Licenses
238I For Occupations and Privileges
238k7 Constitutionality and Validity of Acts and Ordinances
238k7(1) k. In General. Most Cited Cases
(Formerly 371k37.4)

Where foreign manufacturer's Washington-based employee, an engineer who worked full time in the State of Washington, made possible the realization and continuance of valuable contractual relations between the manufacturer and a customer, a Washington aerospace company, the imposition by the State of Washington of its business and occupation tax on the unapportioned gross receipts of the manufacturer resulting from its sales to the Washington customer was not violative of due process, since the measure of the tax bore a relationship to the benefits conferred on the manufacturer by the State of Washington. RCWA 82.04.270.

[2] Commerce 83 ⇐74.20

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k74.20 k. Gross Receipts Taxes. Most Cited Cases
(Formerly 83k70)

Business and occupation tax imposed by the State of Washington on the unapportioned gross receipts of foreign manufacturer resulting from its sales of aerospace fasteners to Washington aerospace company was not repugnant to the commerce clause, where the manufacturer, which maintained a full-time, salaried employee in Washington whose

APPENDIX 2-1

primary duty was to consult with the Washington customer regarding its anticipated needs and to follow up any postdelivery difficulties in using the fasteners, made no showing of multiple taxation on its interstate business, and where the tax was apportioned exactly to the activities taxed, all of which were intrastate. RCWA 82.04.270; U.S.C.A. Const. Art. 1, § 8, cl. 3.

****707 *560** Syllabus[FN*]

> FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See United States v. Detroit Timber & Lumber Co., 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499, 505.

Appellant manufacturer, with a home office and manufacturing plant in Pennsylvania and another plant in California, challenges the constitutionality of Washington State's business and occupation tax which was levied on the unapportioned gross receipts of appellant resulting from its sale of aerospace fasteners to Boeing, its principal Washington customer. Appellant's one Washington-based employee, an engineer, whose office was in his home but who took no fastener orders from Boeing, primarily consulted with Boeing regarding its anticipated fastener needs and followed up any difficulties in the use of fasteners after delivery. The state taxing authorities found that appellant's business activities in Washington were sufficient to sustain the tax, and that decision was affirmed on appeal. Held: Washington's business and occupation tax on appellant is constitutional. Pp. 708-709.

(a) There is no violation of due as the measure of the tax bears a relationship to the benefits conferred on appellant by the State. P. 708.

(b) The tax is not repugnant to the Commerce Clause, appellant having made no showing of multiple taxation on its interstate business, the tax being apportioned to the activities taxed, all of which are intrastate. General Motors Corp. v. Washington, 377 U.S. 436, 84 S.Ct. 1564, 12 L.Ed.2d 430. Pp. 708-709.

10 Wash.App. 45, 516 P.2d 1043, affirmed.
Kenneth L. Cornell, Seattle, Wash., for appellant.

Slade Gorton, Atty. Gen., for appellee.

DOUGLAS, J., wrote the opinion for a unanimous Court.

****708 *561** Opinion of the Court by Mr. Justice DOUGLAS, announced by Mr. Chief Justice BURGER.

Appellant, a manufacturer of industrial and aerospace fasteners (nuts and bolts generally), has its home office in Pennsylvania, one manufacturing plant there and another in California. Its principal customer in the State of Washington is the Boeing Company, in Seattle. In the years relevant here it had one employee, one Martinson, in Washington who was paid a salary and who operated out of his home near Seattle. He was an engineer whose primary duty was to consult with Boeing regarding its anticipated needs and requirements for aerospace fasteners and to follow up any difficulties in the use of appellant's product after delivery. Martinson was assisted by a group of engineers of appellant who visited Boeing about three days every six weeks, their meetings being arranged by Martinson. Martinson did not take orders from Boeing; they were sent directly to appellant. Orders accepted would be filled and shipment made by common carrier to Boeing direct, all payments being made directly to appellant. Martinson had no office except in his home; he had no secretary; but appellant maintained an answering service in the Seattle area which received calls for Martinson, bills for that service being sent direct to appellant.

The State Board of Tax Appeals found that the activities of Martinson were necessary to appellant in making it aware of which products Boeing might use, in obtaining the engineering design of those

products, in securing the testing of sample products to qualify them for sale to Boeing, in resolving problems of their use after receipt by Boeing, in obtaining and retaining good will and rapport with Boeing personnel, and in keeping the invoicing personnel of appellant up to date on Boeing's lists of purchasing specialists or control buyers. The Board sustained the assessment of the Washington business and occupation ***562** tax, Wash.Rev.Code s 82.04.270 (1972), levied on the unapportioned gross receipts of appellant resulting from its sale of fasteners to Boeing. [FN1] The Superior Court affirmed the Board, and the Court of Appeals in turn affirmed, 10 Wash.App. 45, 516 P.2d 1043 (1973). The Supreme Court denied review. The constitutionality, as applied, of the Washington statute being challenged, we noted probable jurisdiction, 417 U.S. 966, 94 S.Ct. 3169, 41 L.Ed.2d 1138 (1974).

> FN1. Appellant paid the taxes under protest, and it is stipulated that should appellant prevail it would be entitled to a refund of $33,444.91.

[1] Appellant argues that imposition of the tax violates due process because the in-state activities were so thin and inconsequential as to make the tax on activities occurring beyond the borders of the State one which has no reasonable relation to the protection and benefits conferred by the taxing State, Wisconsin v. J. C. Penney Co., 311 U.S. 435, 61 S.Ct. 246, 85 L.Ed. 267 (1940). In other words the question is 'whether the state has given anything for which it can ask return,' id., at 444, 61 S.Ct. at 250. We think the question in the context of the present case verges on the frivolous. For appellant's employee, Martinson, with a full-time job within the State, made possible the realization and contin uance of valuable contractual relations between appellant and Boeing.

[2] The case is argued on the interstate commerce aspect as if Washington were taxing the privilege of doing an interstate business with only orders being sent from within the State and filled outside the State, McLeod v. Dilworth Co., 322 U.S. 327, 64 S.Ct. 1023, 88 L.Ed. 1304 (1944). Much reliance is placed on Norton Co. v. Department of Revenue, 340 U.S. 534, 71 S.Ct. 377, 95 L.Ed. 517 (1951), where a Massachusetts corporation qualified to do business in Illinois and maintained an office there from which it made local sales at retail. It was accordingly subjected to the Illinois gross receipts tax on retailers. There were, however, orders sent ****709** by Illinois buyers directly to Massachusetts, filled there, and shipped directly ***563** to the customer. As to these a divided Court held that the income from those sales was not taxable by Illinois by reason of the Commerce Clause. The disagreement in the Court was not over the governing principle; it concerned the burden of showing a nexus between the local office and interstate sales-whether a nexus could be assumed and whether the taxpayer had carried the burden of establishing its immunity.

General Motors Corp. v. Washington, 377 U.S. 436, 84 S.Ct. 1564, 12 L.Ed.2d 430 (1964), is almost precisely in point so far as the present controversy goes. While the zone manager for sales of the Chevrolet, Pontiac, and Oldsmobile divisions was in Portland, Ore., district managers lived and operated within Washington. Each operated from his home, having no separate office. Each had from 12 to 30 dealers under supervision. He called on each of these dealers, kept tabs on the sales forces, and advised as to promotional and training plans. He also advised on used car inventory control. He worked out with the dealer estimated needs over a 30-, 60-, and 90-day projection of orders. General Motors also had in Washington service representatives who called on dealers regularly, assisted in any troubles experienced, and checked the adequacy of the service department's inventory. They conducted service clinics, teaching dealers and employees efficient service techniques. We held that these activities served General Motors as effectively when administered from 'homes' as from 'offices' and that those services were substantial 'with relation to the establishment and maintenance of sales, upon which the tax was measured,' id., at 447, 84 S.Ct. at

1571.

We noted in General Motors that a vice in a tax on gross receipts of a corporation doing an interstate business is the risk of multiple taxation; but that the burden is on the taxpayer to demonstrate it, id., at 449, 84 S.Ct. 1564. The corporation made no such showing there. Nor is any effort made to establish it here. This very tax was ***564** involved in Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434, 59 S.Ct. 325, 83 L.Ed. 272 (1939). The taxpayer was a Washington corporation, doing business there and shipping fruit from Washington to places of sale in the various States and in foreign countries. The Court held the tax, as applied, unconstitutional under the Commerce Clause.

'Here the tax, measured by the entire volume of the interstate commerce in which appellant participates, is not apportioned to its activities within the state. If Washington is free to exact such a tax, other states to which the commerce extends may, with equal right, lay a tax similarly measured for the privilege of conducting within their respective territorial limits the activities there which contribute to the service. The present tax, though nominally local, thus in its practical operation discriminates against interstate commerce, since it imposes upon it, merely because interstate commerce is being done, the risk of a multiple burden to which local commerce is not exposed.' Id., at 439, 59 S.Ct. at 328.

In the instant case, as in Ficklen v. Shelby County Taxing District, 145 U.S. 1, 12 S.Ct. 810, 36 L.Ed. 601 (1892),[FN2] the tax is on the gross receipts from sales made to a local consumer, which may have some impact on commerce. Yet as we said in Gwin, White & Prince, supra, 305 U.S., at 440, 59 S.Ct., at 328, in describing the tax in Ficklen, it is 'apportioned exactly to the activities taxed,' and of which are intrastate.

> FN2. In that case the taxpayers did business as brokers in Tennessee. They solicited local customers and sent their orders to out-of-state vendors who shipped directly to the purchaser. Tennessee levied a tax on their gross commissions. The Court, in distinguishing the 'drummer' cases illustrated by Robbins v. Shelby County Taxing District, 120 U.S. 489, 7 S.Ct. 592, 30 L.Ed. 694 (1887), stated that in Ficklen Tennessee did not tax more than its own internal commerce.

Affirmed.

U.S.Wash. 1975.
Standard Pressed Steel Co. v. Washington Dept. of Revenue
419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719

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112 S.Ct. 1904
504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91, 60 USLW 4423
(Cite as: 504 U.S. 298, 112 S.Ct. 1904)

Supreme Court of the United States
QUILL CORPORATION, Petitioner
v.
NORTH DAKOTA By and Through its Tax Commissioner, Heidi HEITKAMP.
No. 91-194.

Argued Jan. 22, 1992
Decided May 26, 1992.

State brought declaratory judgment action seeking declaration that out-of-state retailer was required to collect and remit applicable state use tax. Retailer's motion for summary judgment was granted by the District Court, Burleigh County, South Central Judicial District, Benny A. Graff, J., and state appealed. The North Dakota Supreme Court, VandeWalle, J., 470 N.W.2d 203, reversed. On petition for writ of certiorari, the Supreme Court, Justice Stevens, held that: (1) mail-order business did not need to have physical presence in state in order to permit state to require business to collect use tax from its in-state customers, but (2) physical presence in state was required for business to have "substantial nexus" with taxing state required by commerce clause.

Reversed and remanded.

Justice White concurred in part and dissented in part and filed opinion.

Justice Scalia concurred in part and concurred in judgment and filed opinion, in which Justice Kennedy and Justice Thomas joined.

West Headnotes

[1] Commerce 83 ⚿62.71

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k62.70 Taxation in General
83k62.71 k. In General. Most Cited Cases
(Formerly 83k62.70)

Constitutional Law 92 ⚿4135

92 Constitutional Law
92XXVII Due Process
92XXVII(G) Particular Issues and Applications
92XXVII(G)6 Taxation
92k4135 k. In General. Most Cited Cases
(Formerly 92k281.5)
Due process and commerce clauses impose distinct limits on taxing powers of states. U.S.C.A. Const.Amend. 14; U.S.C.A. Const. Art. 1, § 8, cl. 3.

[2] Constitutional Law 92 ⚿4135

92 Constitutional Law
92XXVII Due Process
92XXVII(G) Particular Issues and Applications
92XXVII(G)6 Taxation
92k4135 k. In General. Most Cited Cases
(Formerly 92k281.5)
Due process requires both that some definite link or minimum connection exist between state and the person, property or transaction it seeks to tax, and that income attributed to state for tax purposes be rationally related to values connected with taxing state. U.S.C.A. Const.Amend. 14.

[3] Constitutional Law 92 ⚿4145

92 Constitutional Law
92XXVII Due Process
92XXVII(G) Particular Issues and Applications
92XXVII(G)6 Taxation
92k4145 k. Sales and Use Taxes. Most

Cited Cases
(Formerly 92k285.4)

Taxation 371 ⚖3609

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(A) In General
371k3607 Power to Impose
371k3609 k. Territorial Limitations; Nonresidents. Most Cited Cases
(Formerly 371k1206)
Mail-order business did not need to have physical presence in state in order to permit state, consistent with requirements of due process, to require it to collect use tax from its in-state customers; overruling *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 87 S.Ct. 1389. U.S.C.A. Const.Amend. 14.

[4] Constitutional Law 92 ⚖4145

92 Constitutional Law
92XXVII Due Process
92XXVII(G) Particular Issues and Applications
92XXVII(G)6 Taxation
92k4145 k. Sales and Use Taxes. Most Cited Cases
(Formerly 92k285.4)

Taxation 371 ⚖3632

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordin- ances
371k3632 k. Assessment and Collection Provisions. Most Cited Cases
(Formerly 371k1218)
Imposition of duty to collect use tax on out-of-state mail order business with no sales force and insignificant tangible property in state did not violate due process, where business annually mailed 24 tons of catalogs and flyers into state and had annual sales approaching $1 million to in-state customers. U.S.C.A. Const.Amend. 14.

[5] Commerce 83 ⚖12

83 Commerce
83I Power to Regulate in General
83k11 Powers Remaining in States, and Limitations Thereon
83k12 k. In General. Most Cited Cases
Commerce clause is more than affirmative grant of power; it has negative sweep as well and prohibits certain state actions that interfere with interstate commerce. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[6] Commerce 83 ⚖62.80

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k62.70 Taxation in General
83k62.80 k. Multiple Taxation; Apportionment. Most Cited Cases
Interstate commerce may be required, consistent with commerce clause, to pay its fair share of state taxes. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[7] Commerce 83 ⚖74.5(1)

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k74.5 Sales and Use Taxes
83k74.5(1) k. In General. Most Cited Cases
Vendor whose only contacts with taxing state are by mail or common carrier lacks "substantial nexus" with state and may not be required, consistent with commerce clause, to collect use tax from its in-state customers. U.S.C.A. Const. Art. 1, § 8, cl. 3 .

[8] Commerce 83 ⚖62.71

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k62.70 Taxation in General
83k62.71 k. In General. Most Cited Cases
(Formerly 83k62.70)
"Substantial nexus" requirement imposed by commerce clause on state's ability to tax out-of-state entity is not, like "minimum contacts" requirement imposed by due process clause, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. U.S.C.A. Const. Art. 1, § 8, cl. 3; U.S.C.A. Const.Amend. 14.

[9] Commerce 83 ⚖62.71

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k62.70 Taxation in General
83k62.71 k. In General. Most Cited Cases
(Formerly 83k62.70)

Constitutional Law 92 ⚖4135

92 Constitutional Law
92XXVII Due Process
92XXVII(G) Particular Issues and Applications
92XXVII(G)6 Taxation
92k4135 k. In General. Most Cited Cases
(Formerly 92k281.5)
Corporation may have "minimum contacts" with taxing state, as required by due process clause, and yet lack "substantial nexus" with state as required by commerce clause. U.S.C.A. Const.Amend. 14; U.S.C.A. Const. Art. 1, § 8, cl. 3.

[10] Commerce 83 ⚖62.71

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Constitutional Law 92 ⚖4135

92 Constitutional Law
92XXVII Due Process
92XXVII(G) Particular Issues and Applications
92XXVII(G)6 Taxation
92k4135 k. In General. Most Cited Cases
(Formerly 92k281.5)
Tax may be consistent with due process and yet unduly burden interstate commerce. U.S.C.A. Const.Amend. 14; U.S.C.A. Const. Art. 1, § 8, cl. 3.

****1905 *298** *Syllabus* FN*

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

Respondent North Dakota, through its Tax Commissioner, filed an action in state ****1906** court to require petitioner Quill Corporation-an out-of-state mail-order house with neither outlets nor sales representatives in the State-to collect and pay a use tax on goods purchased for use in the State. The trial court ruled in Quill's favor. It found the case indistinguishable from *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505, which, in holding that a similar Illinois statute violated the Fourteenth Amendment's Due Process Clause and created an unconstitutional burden on interstate commerce, concluded that a "seller whose only connection with customers in the State is by common carrier or the ... mail"

lacked the requisite minimum contacts with the State. *Id.*, at 758, 87 S.Ct., at 1392. The State Supreme Court reversed, concluding, *inter alia,* that, pursuant to *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326, and its progeny, the Commerce Clause no longer mandated the sort of physical-presence nexus suggested in *Bellas Hess;* and that, with respect to the Due Process Clause, cases following *Bellas Hess* had not construed minimum contacts to require physical presence within a State as a prerequisite to the legitimate exercise of state power.

Held:

1. The Due Process Clause does not bar enforcement of the State's use tax against Quill. This Court's due process jurisprudence has evolved substantially since *Bellas Hess,* abandoning formalistic tests focused on a defendant's presence within a State in favor of a more flexible inquiry into whether a defendant's contacts with the forum made it reasonable, in the context of the federal system of Government, to require it to defend the suit in that State. See *Shaffer v. Heitner,* 433 U.S. 186, 212, 97 S.Ct. 2569, 2584, 53 L.Ed.2d 683. Thus, to the extent that this Court's decisions have indicated that the Clause requires a physical presence in a State, they are overruled. In this case, Quill has purposefully directed its activities at North Dakota residents, the magnitude of those contacts are more than sufficient for due process purposes, and the tax is related to the benefits Quill receives from access to the State. Pp. 1909-1911.

2. The State's enforcement of the use tax against Quill places an unconstitutional burden on interstate commerce. Pp. 1911-1916.

***299** (a) *Bellas Hess* was not rendered obsolete by this Court's subsequent decision in *Complete Auto, supra,* which set forth the four-part test that continues to govern the validity of state taxes under the Commerce Clause. Although *Complete Auto* renounced an analytical approach that looked to a statute's formal language rather than its practical effect in determining a state tax statute's validity, the *Bellas Hess* decision did not rely on such formalism. Nor is *Bellas Hess* inconsistent with *Complete Auto.* It concerns the first part of the *Complete Auto* test and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the "substantial nexus" required by the Commerce Clause. Pp. 1911-1913.

(b) Contrary to the State's argument, a mail-order house may have the "minimum contacts" with a taxing State as required by the Due Process Clause and yet lack the "substantial nexus" with the State required by the Commerce Clause. These requirements are not identical and are animated by different constitutional concerns and policies. Due process concerns the fundamental fairness of governmental activity, and the touchstone of due process nexus analysis is often identified as "notice" or "fair warning." In contrast, the Commerce Clause and its nexus requirement are informed by structural concerns about the effects of state regulation on the national economy. P. 1913.

(c) The evolution of this Court's Commerce Clause jurisprudence does not indicate repudiation of the *Bellas Hess* rule. While ****1907** cases subsequent to *Bellas Hess* and concerning other types of taxes have not adopted a bright-line, physical presence requirement similar to that in *Bellas Hess,* see, *e.g., Standard Pressed Steel Co. v. Department of Revenue of Wash.,* 419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719, their reasoning does not compel rejection of the *Bellas Hess* rule regarding sales and use taxes. To the contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the rule remains good law. Pp. 1914-1916.

(d) The underlying issue here is one that Congress may be better qualified to resolve and one that it has the ultimate power to resolve. P. 1916.

470 N.W.2d 203 (N.D.1991), reversed and remanded.

STEVENS, J., delivered the opinion for a unanimous Court with respect to Parts I, II, and III, and the opinion of the Court with respect to Part IV, in which REHNQUIST, C.J., and BLACKMUN, O'CONNOR, and SOUTER, JJ., joined. SCALIA, J., filed an opinion concurring in part and concurring in the judgment, in which KENNEDY and THOMAS, JJ., joined, *post,* p. 1923. WHITE, J., filed an opinion concurring in part and dissenting in part, *post,* p. 1916.

***300** *John E. Gaggini* argued the cause for petitioner. With him on the briefs were *Don S. Harnack, Richard A. Hanson, James H. Peters, Nancy T. Owens,* and *William P. Pearce.*

Nicholas J. Spaeth, Attorney General of North Dakota, argued the cause for respondent. With him on the brief were *Laurie J. Loveland,* Solicitor General, *Robert W. Wirtz,* Assistant Attorney General, and *Alan H. Friedman,* Special Assistant Attorney General.*

* Briefs of *amici curiae* urging reversal were filed for the State of New Hampshire et al. by *John P. Arnold,* Attorney General of New Hampshire, and *Harold T. Judd,* Senior Assistant Attorney General, *Charles M. Oberly III,* Attorney General of Delaware, and *John R. McKernan, Jr.,* Governor of Maine; for the American Bankers Association et al. by *John J. Gill III, Michael F. Crotty,* and *Frank M. Salinger;* for the American Council for the Blind et al. by *David C. Todd* and *Timothy J. May;* for Arizona Mail Order Co., Inc., et al. by *Maryann B. Gall, Timothy B. Dyk, Michael J. Meehan, Frank G. Julian, David J. Bradford, George S. Isaacson, Martin I. Eisenstein,* and *Stuart A. Smith;* for Carrot Top Industries, Inc., et al. by *Charles A. Trost* and *James F. Blumstein;* for the Clarendon Foundation by *Ronald D. Maines;* for the Coalition for Small Direct Marketers by *Richard J. Leighton* and *Dan M. Peterson;* for the Direct Marketing Association by *George S. Isaacson, Martin I. Eisenstein,* and *Robert J. Levering;* for the National Association of Manufacturers et al. by *Bruce J. Ennis, Jr., David W. Ogden, Jan S. Amundson,* and *John Kamp;* for Magazine Publishers of America, Inc., et al. by *Eli D. Minton, James R. Cregan, Ian D. Volner,* and *Stephen F. Owen, Jr.;* and for the Tax Executives Institute, Inc., by *Timothy J. McCormally.*

Briefs of *amici curiae* urging affirmance were filed for the State of Connecticut et al. by *Richard Blumenthal,* Attorney General of Connecticut, and *Paul J. Hartman, Charles W. Burson,* Attorney General of Tennessee, *Daniel E. Lungren, Attorney General of California, Winston Bryant,* Attorney General of Arkansas, *Robert A. Butterworth,* Attorney General of Florida, *Michael J. Bowers,* Attorney General of Georgia, *Larry EchoHawk,* Attorney General of Idaho, *Roland W. Burris,* Attorney General of Illinois, *Bonnie J. Campbell,* Attorney General of Iowa, *Frederic J. Cowan,* Attorney General of Kentucky, *William J. Guste, Jr.,* Attorney General of Louisiana, *J. Joseph Curran, Jr.,* Attorney General of Maryland, *Scott Harshbarger,* Attorney General of Massachusetts, *Frank J. Kelley,* Attorney General of Michigan, *Mike Moore,* Attorney General of Mississippi, *Frankie Sue Del Papa,* Attorney General of Nevada, *Robert Abrams,* Attorney General of New York, *Lee Fisher,* Attorney General of Ohio, *Susan B. Loving,* Attorney General of Oklahoma, *Ernest D. Preate, Jr.,* Attorney General of Pennsylvania, *T. Travis Medlock,* Attorney General of South Carolina, *Dan Morales,* Attorney General of Texas, *Paul Van Dam,* Attorney General of Utah, *Jeffrey L. Amestoy,* Attorney General of Vermont, *Mary Sue Terry,* Attorney General of Virginia, *Ken Eikenberry,* Attorney General of Washington, *Mario J. Palumbo,* Attorney General of West Virginia, and *John Payton;* for the State of New Jersey by *Robert J. Del Tufo,* Attorney General, *Sarah T. Darrow,* Deputy Attorney General, *Joseph L. Wannotti,* Assistant Attorney General, *Richard G. Taranto,* and *Joel I. Klein;* for the State of New Mexico by *Tom Udall,* Attorney General, and *Frank D. Katz,* Special Assistant Attorney General; for the City of New York by *O. Peter Sherwood, Edward F. X. Hart,* and *Stanley Buchsbaum;* for the International Council of Shopping Centers, Inc., et al. by *Charles Rothfeld;* for the Multistate

Tax Commission by *James F. Flug* and *Martin Lobel;* for the National Governors'Association et al. by *Richard Ruda;* and for the Tax Policy Research Project by *Rita Marie Cain.*

***301** Justice STEVENS delivered the opinion of the Court.

This case, like *National Bellas Hess, Inc. v. Department of Revenue of Ill.,* 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), involves a State's attempt to require an out-of-state mail-order house that has neither outlets nor sales representatives in the State to collect and pay a use tax on goods purchased for use within the State. In *Bellas Hess* we held that a similar Illinois statute violated the Due Process Clause of the Fourteenth Amendment and created an unconstitutional burden on interstate commerce. In particular, we ruled that a "seller whose only connection with customers in the State is by common carrier or the United States mail" lacked the requisite minimum contacts with the State. *Id.,* at 758, 87 S.Ct., at 1392.

In this case, the Supreme Court of North Dakota declined to follow *Bellas Hess* because "the tremendous social, economic, commercial, and legal innovations" of the past quarter-century have rendered its holding "obsole [te]." 470 N.W.2d 203, 208 (1991). Having granted certiorari, 502 U.S. 808, 112 S.Ct. 49, 116 L.Ed.2d 27, we must either reverse the State Supreme Court ***302** or overrule *Bellas Hess.* While we agree with much of the state court's reasoning, we take the former course.

I

Quill is a Delaware corporation with offices and warehouses in Illinois, California, and Georgia. None of its employees work or reside in North Dakota, and its ownership of tangible property in that State is either insignificant or nonexistent.[FN1] Quill sells office equipment and supplies; it solicits business through catalogs and flyers, advertisements in national periodicals, and telephone calls. Its annual national sales exceed $200 million, ****1908** of which almost $1 million are made to about 3,000 customers in North Dakota. It is the sixth largest vendor of office supplies in the State. It delivers all of its merchandise to its North Dakota customers by mail or common carrier from out-of-state locations.

> FN1. In the trial court, the State argued that because Quill gave its customers an unconditional 90-day guarantee, it retained title to the merchandise during the 90-day period after delivery. The trial court held, however, that title passed to the purchaser when the merchandise was received. See App. to Pet. for Cert. A40-A41. The State Supreme Court assumed for the purposes of its decision that that ruling was correct. 470 N.W.2d 203, 217, n. 13 (1991). The State Supreme Court also noted that Quill licensed a computer software program to some of its North Dakota customers that enabled them to check Quill's current inventories and prices and to place orders directly. *Id.,* at 216-217. As we shall explain, Quill's interests in the licensed software does not affect our analysis of the due process issue and does not comprise the "substantial nexus" required by the Commerce Clause. See n. 8, *infra.*

As a corollary to its sales tax, North Dakota imposes a use tax upon property purchased for storage, use, or consumption within the State. North Dakota requires every "retailer maintaining a place of business in" the State to collect the tax from the consumer and remit it to the State. N.D.Cent.Code § 57-40.2-07 (Supp.1991). In 1987, North Dakota amended the statutory definition of the term "retailer" to include "every person who engages in regular or systematic***303** solicitation of a consumer market in th[e] state." § 57-40.2-01(6). State regulations in turn define "regular or systematic solicitation" to mean three or more advertisements within a 12-month period. N.D.Admin.Code §

81-04.1-01-03.1 (1988). Thus, since 1987, mail-order companies that engage in such solicitation have been subject to the tax even if they maintain no property or personnel in North Dakota.

Quill has taken the position that North Dakota does not have the power to compel it to collect a use tax from its North Dakota customers. Consequently, the State, through its Tax Commissioner, filed this action to require Quill to pay taxes (as well as interest and penalties) on all such sales made after July 1, 1987. The trial court ruled in Quill's favor, finding the case indistinguishable from *Bellas Hess;* specifically, it found that because the State had not shown that it had spent tax revenues for the benefit of the mail-order business, there was no "nexus to allow the state to define retailer in the manner it chose." App. to Pet. for Cert. A41.

The North Dakota Supreme Court reversed, concluding that "wholesale changes" in both the economy and the law made it inappropriate to follow *Bellas Hess* today. 470 N.W.2d, at 213. The principal economic change noted by the court was the remarkable growth of the mail-order business "from a relatively inconsequential market niche" in 1967 to a "goliath" with annual sales that reached "the staggering figure of $183.3 billion in 1989." *Id.,* at 208, 209. Moreover, the court observed, advances in computer technology greatly eased the burden of compliance with a " 'welter of complicated obligations' " imposed by state and local taxing authorities. *Id.,* at 215 (quoting *Bellas Hess,* 386 U.S., at 759-760, 87 S.Ct., at 1393).

Equally important, in the court's view, were the changes in the "legal landscape." With respect to the Commerce Clause, the court emphasized that *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), rejected the line of cases holding that the direct taxation of interstate commerce was ***304** impermissible and adopted instead a "consistent and rational method of inquiry [that focused on] the practical effect of [the] challenged tax." *Mobil Oil Corp. v. Commissioner of Taxes of Vt.,* 445 U.S. 425, 443, 100 S.Ct. 1223, 1234, 63 L.Ed.2d 510 (1980). This and subsequent rulings, the court maintained, indicated that the Commerce Clause no longer mandated the sort of physical-presence nexus suggested in *Bellas Hess.*

Similarly, with respect to the Due Process Clause, the North Dakota court observed that cases following *Bellas Hess* had not construed "minimum contacts" to require physical presence within a State as a prerequisite to the legitimate exercise of state power. The state court then concluded that "the Due Process requirement of a 'minimal connection' to establish nexus is encompassed within the *Complete Auto* test" and that the relevant inquiry under the latter test was whether "the state has provided some protection, opportunities, or benefit for which it can expect a return." 470 N.W.2d, at 216.

Turning to the case at hand, the state court emphasized that North Dakota had ****1909** created "an economic climate that fosters demand for" Quill's products, maintained a legal infrastructure that protected that market, and disposed of 24 tons of catalogs and flyers mailed by Quill into the State every year. *Id.,* at 218-219. Based on these facts, the court concluded that Quill's "economic presence" in North Dakota depended on services and benefits provided by the State and therefore generated "a constitutionally sufficient nexus to justify imposition of the purely administrative duty of collecting and remitting the use tax." *Id.,* at 219.[FN2]

> FN2. The court also suggested that, in view of the fact that the "touchstone of Due Process is fundamental fairness" and that the "very object" of the Commerce Clause is protection of interstate business against discriminatory local practices, it would be ironic to exempt Quill from this burden and thereby allow it to enjoy a significant competitive advantage over local retailers. 470 N.W.2d, at 214-215.

***305** II

[1] As in a number of other cases involving the application of state taxing statutes to out-of-state sellers, our holding in *Bellas Hess* relied on both the Due Process Clause and the Commerce Clause. Although the "two claims are closely related," *Bellas Hess,* 386 U.S., at 756, 87 S.Ct., at 1391, the Clauses pose distinct limits on the taxing powers of the States. Accordingly, while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause. See, *e.g., Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue,* 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987).

The two constitutional requirements differ fundamentally, in several ways. As discussed at greater length below, see Part IV, *infra,* the Due Process Clause and the Commerce Clause reflect different constitutional concerns. Moreover, while Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce, see *International Shoe Co. v. Washington,* 326 U.S. 310, 315, 66 S.Ct. 154, 157, 90 L.Ed. 95 (1945), it does not similarly have the power to authorize violations of the Due Process Clause.

Thus, although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct.

> " 'Due process' and 'commerce clause' conceptions are not always sharply separable in dealing with these problems.... To some extent they overlap. If there is a want of due process to sustain the tax, by that fact alone any burden the tax imposes on the commerce among the states becomes 'undue.' But, though overlapping, the two conceptions are not identical. There may be more than sufficient factual connections, with economic and legal effects, between the transaction and the taxing state to sustain the tax as against due process ***306** objections. Yet it may fall because of its burdening effect upon the commerce. And, although the two notions cannot always be separated, clarity of consideration and of decision would be promoted if the two issues are approached, where they are presented, at least tentatively as if they were separate and distinct, not intermingled ones." *International Harvester Co. v. Department of Treasury,* 322 U.S. 340, 353, 64 S.Ct. 1019, 1032-1033, 88 L.Ed. 1313 (1944) (Rutledge, J., concurring in part and dissenting in part).

Heeding Justice Rutledge's counsel, we consider each constitutional limit in turn.

III

[2][3] The Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," *Miller Brothers Co. v. Maryland,* 347 U.S. 340, 344-345, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954), and that the "income attributed to the State for tax purposes must be rationally related to ****1910** 'values connected with the taxing State,' " *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 273, 98 S.Ct. 2340, 2344, 57 L.Ed.2d 197 (1978) (citation omitted). Here, we are concerned primarily with the first of these requirements. Prior to *Bellas Hess,* we had held that that requirement was satisfied in a variety of circumstances involving use taxes. For example, the presence of sales personnel in the State[FN3] or the maintenance of local retail stores in the State[FN4] justified the exercise of that power because the seller's local activities were "plainly accorded the protection and services of the taxing State." *Bellas Hess,* 386 U.S., at 757, 87 S.Ct., at 1391. The furthest extension of that power was recognized in *Scripto, Inc. v. Carson,* 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960), in which the Court upheld a use tax despite the fact that all of the seller's in-state solicitation was performed by independent contractors. These cases all involved some sort of physical presence within the State, and in *Bellas Hess* ***307** the Court suggested that such presence was not only sufficient for jurisdiction un-

der the Due Process Clause, but also necessary. We expressly declined to obliterate the "sharp distinction ... between mail-order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as a part of a general interstate business." 386 U.S., at 758, 87 S.Ct., at 1392.

FN3. *Felt & Tarrant Mfg. Co. v. Gallagher,* 306 U.S. 62, 59 S.Ct. 376, 83 L.Ed. 488 (1939).

FN4. *Nelson v. Sears, Roebuck & Co.,* 312 U.S. 359, 61 S.Ct. 586, 85 L.Ed. 888 (1941).

Our due process jurisprudence has evolved substantially in the 25 years since *Bellas Hess,* particularly in the area of judicial jurisdiction. Building on the seminal case of *International Shoe Co. v. Washington,* 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945) , we have framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction "such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.' " *Id.,* at 316, 66 S.Ct., at 158 (quoting *Milliken v. Meyer,* 311 U.S. 457, 463, 61 S.Ct. 339, 343, 85 L.Ed. 278 (1940)). In that spirit, we have abandoned more formalistic tests that focused on a defendant's "presence" within a State in favor of a more flexible inquiry into whether a defendant's contacts with the forum made it reasonable, in the context of our federal system of Government, to require it to defend the suit in that State. In *Shaffer v. Heitner,* 433 U.S. 186, 212, 97 S.Ct. 2569, 2584, 53 L.Ed.2d 683 (1977), the Court extended the flexible approach that *International Shoe* had prescribed for purposes of *in personam* jurisdiction to *in rem* jurisdiction, concluding that "all assertions of state-court jurisdiction must be evaluated according to the standards set forth in *International Shoe* and its progeny."

Applying these principles, we have held that if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's *in personam* jurisdiction even if it has no physical presence in the State. As we explained in *Burger King Corp. v. Rudzewicz,* 471 U.S. 462, 105 S.Ct. 2174, 85 L.Ed.2d 528 (1985):

> "Jurisdiction in these circumstances may not be avoided merely because the defendant did not *physically*308* enter the forum State. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat ****1911** personal jurisdiction there." *Id.,* at 476, 105 S.Ct. at 2184 (emphasis in original).

Comparable reasoning justifies the imposition of the collection duty on a mail-order house that is engaged in continuous and widespread solicitation of business within a State. Such a corporation clearly has "fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign." *Shaffer v. Heitner,* 433 U.S., at 218, 97 S.Ct., at 2587 (STEVENS, J., concurring in judgment). In "modern commercial life" it matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State. Thus, to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of duty to collect a use tax, we overrule those holdings as superseded by developments in the law of due process.

[4] In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State. We therefore agree with the North Dakota Supreme Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill.

***309** IV

[5] Article I, § 8, cl. 3, of the Constitution expressly authorizes Congress to "regulate Commerce with foreign Nations, and among the several States." It says nothing about the protection of interstate commerce in the absence of any action by Congress. Nevertheless, as Justice Johnson suggested in his concurring opinion in *Gibbons v. Ogden,* 9 Wheat. 1, 231-232, 239, 6 L.Ed. 23 (1824), the Commerce Clause is more than an affirmative grant of power; it has a negative sweep as well. The Clause, in Justice Stone's phrasing, "by its own force" prohibits certain state actions that interfere with interstate commerce. *South Carolina State Highway Dept. v. Barnwell Brothers, Inc.,* 303 U.S. 177, 185, 58 S.Ct. 510, 514, 82 L.Ed. 734 (1938).

[6] Our interpretation of the "negative" or "dormant" Commerce Clause has evolved substantially over the years, particularly as that Clause concerns limitations on state taxation powers. See generally P. Hartman, Federal Limitations on State and Local Taxation §§ 2:9-2:17 (1981). Our early cases, beginning with *Brown v. Maryland,* 12 Wheat. 419, 6 L.Ed. 678 (1827), swept broadly, and in *Leloup v. Port of Mobile,* 127 U.S. 640, 648, 8 S.Ct. 1380, 1384, 32 L.Ed. 311 (1888), we declared that "no State has the right to lay a tax on interstate commerce in any form." We later narrowed that rule and distinguished between direct burdens on interstate commerce, which were prohibited, and indirect burdens, which generally were not. See, *e.g., Sanford v. Poe,* 69 F. 546 (CA6 1895), aff'd *sub nom. Adams Express Co. v. Ohio State Auditor,* 165 U.S. 194, 220, 17 S.Ct. 305, 308, 41 L.Ed. 683 (1897). *Western Live Stock v. Bureau of Revenue,* 303 U.S. 250, 256-258, 58 S.Ct. 546, 549-550, 82 L.Ed. 823 (1938), and subsequent decisions rejected this formal, categorical analysis and adopted a "multiple-taxation doctrine" that focused not on whether a tax was "direct" or "indirect" but rather on whether a tax subjected interstate commerce to a risk of multiple taxation. However, in *Freeman v. Hewit,* 329 U.S. 249, 256, 67 S.Ct. 274, 278, 91 L.Ed. 265 (1946), we embraced again the formal distinction between direct and indirect taxation, invalidating Indiana's imposition of a gross receipts tax on a ***310** particular transaction because that application would "impos[e] a direct tax on interstate sales." Most recently, in *Complete Auto Transit, Inc. v. Brady,* 430 U.S., at 285, 97 S.Ct., at 1082, we renounced the *Freeman* approach as "attaching constitutional significance to a semantic difference." We expressly overruled one of ****1912** *Freeman's* progeny, *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573 (1951), which held that a tax on "the privilege of doing interstate business" was unconstitutional, while recognizing that a differently denominated tax with the same economic effect would not be unconstitutional. *Spector,* as we observed in *Railway Express Agency, Inc. v. Virginia,* 358 U.S. 434, 441, 79 S.Ct. 411, 416, 3 L.Ed.2d 450 (1959), created a situation in which "magic words or labels" could "disable an otherwise constitutional levy." *Complete Auto* emphasized the importance of looking past "the formal language of the tax statute [to] its practical effect," 430 U.S., at 279, 97 S.Ct., at 1079, and set forth a four-part test that continues to govern the validity of state taxes under the Commerce Clause.[FN5]

> FN5. Under our current Commerce Clause jurisprudence, "with certain restrictions, interstate commerce may be required to pay its fair share of state taxes." *D.H. Holmes Co. v. McNamara,* 486 U.S. 24, 31, 108 S.Ct. 1619, 1623, 100 L.Ed.2d 21 (1988); see also *Commonwealth Edison*

> *Co. v. Montana,* 453 U.S. 609, 623-624, 101 S.Ct. 2946, 2957, 69 L.Ed.2d 884 (1981) ("It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of [the] state tax burden even though it increases the cost of doing business") (internal quotation marks and citation omitted).

[7] *Bellas Hess* was decided in 1967, in the middle of this latest rally between formalism and pragmatism. Contrary to the suggestion of the North Dakota Supreme Court, this timing does not mean that *Complete Auto* rendered *Bellas Hess* "obsolete." *Complete Auto* rejected *Freeman* and *Spector's* formal distinction between "direct" and "indirect" taxes on interstate commerce because that formalism allowed the validity of statutes to hinge on "legal terminology," "draftsmanship and phraseology." 430 U.S., at 281, 97 S.Ct., at 1080. *Bellas Hess* ***311** did not rely on any such labeling of taxes and therefore did not automatically fall with *Freeman* and its progeny.

While contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, *Bellas Hess* is not inconsistent with *Complete Auto* and our recent cases. Under *Complete Auto* 's four-part test, we will sustain a tax against a Commerce Clause challenge so long as the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." 430 U.S., at 279, 97 S.Ct., at 1079. *Bellas Hess* concerns the first of these tests and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the "substantial nexus" required by the Commerce Clause.

Thus, three weeks after *Complete Auto* was handed down, we cited *Bellas Hess* for this proposition and discussed the case at some length. In *National Geographic Society v. California Bd. of Equalization,* 430 U.S. 551, 559, 97 S.Ct. 1386, 1392, 51 L.Ed.2d 631 (1977), we affirmed the continuing vitality of *Bellas Hess* ' "sharp distinction ... between mail-order sellers with [a physical presence in the taxing] State and those ... who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business." We have continued to cite *Bellas Hess* with approval ever since. For example, in *Goldberg v. Sweet,* 488 U.S. 252, 263, 109 S.Ct. 582, 589, 102 L.Ed.2d 607 (1989), we expressed "doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call. See *National Bellas Hess* ... (receipt of mail provides insufficient nexus)." See also *D.H. Holmes Co. v. McNamara,* 486 U.S. 24, 33, 108 S.Ct. 1619, 1624, 100 L.Ed.2d 21 (1988); *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 626, 101 S.Ct. 2946, 2958, 69 L.Ed.2d 884 (1981); *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S., at 437, 100 S.Ct., at 1231; ****1913***National Geographic Society,* 430 U.S., at 559, 97 S.Ct., at 1391. For these reasons, we disagree with the State Supreme Court's conclusion***312** that our decision in *Complete Auto* undercut the *Bellas Hess* rule.

The State of North Dakota relies less on *Complete Auto* and more on the evolution of our due process jurisprudence. The State contends that the nexus requirements imposed by the Due Process and Commerce Clauses are equivalent and that if, as we concluded above, a mail-order house that lacks a physical presence in the taxing State nonetheless satisfies the due process "minimum contacts" test, then that corporation also meets the Commerce Clause "substantial nexus" test. We disagree. Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated by different constitutional concerns and policies.

Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis re-

quires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis. In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills. See generally The Federalist Nos. 7, 11 (A. Hamilton). It is in this light that we have interpreted the negative implication of the Commerce Clause. Accordingly, we have ruled that that Clause prohibits discrimination against interstate commerce, see, *e.g., Philadelphia v. New Jersey,* 437 U.S. 617, 98 S.Ct. 2531, 57 L.Ed.2d 475 (1978), and bars state regulations that unduly burden interstate commerce, see, *e.g., Kassel v. Consolidated Freightways Corp. of Del.,* 450 U.S. 662, 101 S.Ct. 1309, 67 L.Ed.2d 580 (1981).

***313** [8][9][10] The *Complete Auto* analysis reflects these concerns about the national economy. The second and third parts of that analysis, which require fair apportionment and non-discrimination, prohibit taxes that pass an unfair share of the tax burden onto interstate commerce. The first and fourth prongs, which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce.[FN6] Thus, the "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, contrary to the State's suggestion, a corporation may have the "minimum contacts" with a taxing State as required by the Due Process Clause, and yet lack the "substantial ****1914** nexus" with that State as required by the Commerce Clause.[FN7]

FN6. North Dakota's use tax illustrates well how a state tax might unduly burden interstate commerce. On its face, North Dakota law imposes a collection duty on every vendor who advertises in the State three times in a single year. Thus, absent the *Bellas Hess* rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation's 6,000-plus taxing jurisdictions. See *National Bellas Hess, Inc. v. Department of Revenue of Ill.,* 386 U.S. 753, 759-760, 87 S.Ct. 1389, 1393, 18 L.Ed.2d 505 (1967) (noting that the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations") (footnotes omitted); see also Shaviro, An Economic and Political Look at Federalism in Taxation, 90 Mich.L.Rev. 895, 925-926 (1992).

FN7. We have sometimes stated that the " *Complete Auto* test, while responsive to Commerce Clause dictates, encompasses as well ... due process requirement[s]." *Trinova Corp. v. Michigan Dept. of Treasury,* 498 U.S. 358, 373, 111 S.Ct. 818, 828, 112 L.Ed.2d 884 (1991). Although such comments might suggest that every tax that passes contemporary Commerce Clause analysis is also valid under the Due Process Clause, it does not follow that the converse is as well true: A tax may be consistent with due process and yet unduly burden interstate commerce. See, *e.g., Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue,* 483 U.S. 232, 107

S.Ct. 2810, 97 L.Ed.2d 199 (1987).

*314 The State Supreme Court reviewed our recent Commerce Clause decisions and concluded that those rulings signaled a "retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach" and thus supported its decision not to apply *Bellas Hess.* 470 N.W.2d, at 214 (citing *Standard Pressed Steel Co. v. Department of Revenue of Wash.,* 419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719 (1975), and *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue,* 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987)). Although we agree with the state court's assessment of the evolution of our cases, we do not share its conclusion that this evolution indicates that the Commerce Clause ruling of *Bellas Hess* is no longer good law.

First, as the state court itself noted, 470 N.W.2d, at 214, all of these cases involved taxpayers who had a physical presence in the taxing State and therefore do not directly conflict with the rule of *Bellas Hess* or compel that it be overruled. Second, and more importantly, although our Commerce Clause jurisprudence now favors more flexible balancing analyses, we have never intimated a desire to reject all established "bright-line" tests. Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule.

Complete Auto, it is true, renounced *Freeman* and its progeny as "formalistic." But not all formalism is alike. *Spector* 's formal distinction between taxes on the "privilege of doing business" and all other taxes served no purpose within our Commerce Clause jurisprudence, but stood "only as a trap for the unwary draftsman." *Complete Auto,* 430 U.S., at 279, 97 S.Ct. at 1079. In contrast, the bright-line rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause. Undue *315 burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation. *Bellas Hess* followed the latter approach and created a safe harbor for vendors "whose only connection with customers in the [taxing] State is by common carrier or the United States mail." Under *Bellas Hess,* such vendors are free from state-imposed duties to collect sales and use taxes.[FN8]

> FN8. In addition to its common-carrier contacts with the State, Quill also licensed software to some of its North Dakota clients. See n. 1, *supra.* The State "concedes that the existence in North Dakota of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base nexus." Brief for Respondent 46. We agree. Although title to "a few floppy diskettes" present in a State might constitute some minimal nexus, in *National Geographic Society v. California Bd. of Equalization,* 430 U.S. 551, 556, 97 S.Ct. 1386, 1390, 51 L.Ed.2d 631 (1977), we expressly rejected a " 'slightest presence' standard of constitutional nexus." We therefore conclude that Quill's licensing of software in this case does not meet the "substantial nexus" requirement of the Commerce Clause.

Like other bright-line tests, the *Bellas Hess* rule appears artificial at its edges: Whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office. Cf. **1915*National Geographic Society v. California Bd. of Equalization,* 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977); *Scripto, Inc. v. Carson,* 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960). This artificiality, however, is more than offset by the benefits of a clear rule. Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes. This benefit

is important, for as we have so frequently noted, our law in this area is something of a "quagmire" and the "application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of ***316** taxation." *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 457-458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959).

Moreover, a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals.[FN9] Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter century is due in part to the bright-line exemption from state taxation created in *Bellas Hess.*

> FN9. It is worth noting that Congress has, at least on one occasion, followed a similar approach in its regulation of state taxation. In response to this Court's indication in *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 452, 79 S.Ct. 357, 359, 3 L.Ed.2d 421 (1959), that, so long as the taxpayer has an adequate nexus with the taxing State, "net income from the interstate operations of a foreign corporation may be subjected to state taxation," Congress enacted Pub.L. 86-272, codified at 15 U.S.C. § 381. That statute provides that a State may not impose a net income tax on any person if that person's "only business activities within such State [involve] the solicitation of orders [approved] outside the State [and] filled ... outside the State." *Ibid.* As we noted in *Heublein, Inc. v. South Carolina Tax Comm'n,* 409 U.S. 275, 280, 93 S.Ct. 483, 487, 34 L.Ed.2d 472 (1972), in enacting § 381, "Congress attempted to allay the apprehension of businessmen that 'mere solicitation' would subject them to state taxation.... Section 381 was designed to define clearly a lower limit for the exercise of [the State's power to tax]. *Clarity that would remove uncertainty was Congress' primary goal.*" (Emphasis supplied.)

Notwithstanding the benefits of bright-line tests, we have, in some situations, decided to replace such tests with more contextual balancing inquiries. For example, in *Arkansas Electric Cooperative Corp. v. Arkansas Pub. Serv. Comm'n,* 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983), we reconsidered a bright-line test set forth in *Public Util. Comm'n of R.I. v. Attleboro Steam & Electric Co.,* 273 U.S. 83, 47 S.Ct. 294, 71 L.Ed. 54 (1927). *Attleboro* distinguished between state regulation of *wholesale* sales of electricity, which was constitutional as an "indirect" regulation of interstate commerce, and state regulation of *retail* sales of electricity, which was unconstitutional as a "direct regulation" of commerce. In *Arkansas Electric,* we considered whether to ***317** "follow the mechanical test set out in *Attleboro,* or the balance-of-interests test applied in our Commerce Clause cases." 461 U.S., at 390-391, 103 S.Ct., at 1916. We first observed that "the principle of *stare decisis* counsels us, here as elsewhere, not lightly to set aside specific guidance of the sort we find in *Attleboro.* " *Id.,* at 391, 103 S.Ct., at 1916. In deciding to reject the *Attleboro* analysis, we were influenced by the fact that the "mechanical test" was "anachronistic," that the Court had rarely relied on the test, and that we could "see no strong reliance interests" that would be upset by the rejection of that test. 461 U.S., at 391-392, 103 S.Ct., at 1916. None of those factors obtains in this case. First, the *Attleboro* rule was "anachronistic" because it relied on formal distinctions between "direct" and "indirect" regulation (and on the regulatory counterparts of our *Freeman* line of cases); as discussed above, *Bellas Hess* turned on a different logic and thus remained sound after the Court repudiated an analogous distinction in *Complete Auto.* Second, unlike the *Attleboro* rule, we have, in our decisions, frequently relied on the *Bellas Hess* rule in the last 25 years, see *supra,* at 1912, and we have never intimated in our review

of sales or use taxes that *Bellas Hess* ****1916** was unsound. Finally, again unlike the *Attleboro* rule, the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizable industry. The "interest in stability and orderly development of the law" that undergirds the doctrine of *stare decisis,* see *Runyon v. McCrary,* 427 U.S. 160, 190-191, 96 S.Ct. 2586, 2604-2605, 49 L.Ed.2d 415 (1976) (STEVENS, J., concurring), therefore counsels adherence to settled precedent.

In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes. To the contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law. For ***318** these reasons, we disagree with the North Dakota Supreme Court's conclusion that the time has come to renounce the bright-line test of *Bellas Hess.*

This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve,[FN10] but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. See *Prudential Insurance Co. v. Benjamin,* 328 U.S. 408, 66 S.Ct. 1142, 90 L.Ed. 1342 (1946). Indeed, in recent years Congress has considered legislation that would "overrule" the *Bellas Hess* rule.[FN11] Its decision not to take action in this direction may, of course, have been dictated by respect for our holding in *Bellas Hess* that the Due Process Clause prohibits States from imposing such taxes, but today we have put that problem to rest. Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.

FN10. Many States have enacted use taxes. See App. 3 to Brief for Direct Marketing Association as *Amicus Curiae.* An overruling of *Bellas Hess* might raise thorny questions concerning the retroactive application of those taxes and might trigger substantial unanticipated liability for mail-order houses. The precise allocation of such burdens is better resolved by Congress rather than this Court.

FN11. See, *e.g.,* H.R. 2230, 101st Cong., 1st Sess. (1989); S. 480, 101st Cong., 1st Sess. (1989); S. 2368, 100th Cong., 2d Sess. (1988); H.R. 3521, 100th Cong., 1st Sess. (1987); S. 1099, 100th Cong., 1st Sess. (1987); H.R. 3549, 99th Cong., 1st Sess. (1985); S. 983, 96th Cong., 1st Sess. (1979); S. 282, 93d Cong., 1st Sess. (1973).

Indeed, even if we were convinced that *Bellas Hess* was inconsistent with our Commerce Clause jurisprudence, "this very fact [might] giv[e us] pause and counse[l] withholding our hand, at least for now. Congress has the power to protect interstate commerce from intolerable or even undesirable burdens." *Commonwealth Edison Co. v. Montana,* 453 U.S., at 637, 101 S.Ct., at 2964, (WHITE, J., concurring). In this situation, it ***319** may be that "the better part of both wisdom and valor is to respect the judgment of the other branches of the Government." *Id.,* at 638, 101 S.Ct., at 2964.

The judgment of the Supreme Court of North Dakota is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

***321** Justice WHITE, concurring in part and dissenting in part.

Today the Court repudiates that aspect of our decision in *National Bellas Hess, Inc. v. Department of Revenue of Ill.,* 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), which restricts, under the Due

Process Clause of the Fourteenth Amendment, the power of the States to impose use tax collection responsibilities**1917 on out-*322 of-state mail-order businesses that do not have a "physical presence" in the State. The Court stops short, however, of giving *Bellas Hess* the complete burial it justly deserves. In my view, the Court should also overrule that part of *Bellas Hess* which justifies its holding under the Commerce Clause. I, therefore, respectfully dissent from Part IV.

I

In Part IV of its opinion, the majority goes to some lengths to justify the *Bellas Hess* physical-presence requirement under our Commerce Clause jurisprudence. I am unpersuaded by its interpretation of our cases. In *Bellas Hess,* the majority placed great weight on the interstate quality of the mail-order sales, stating that "it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved." *Id.,* at 759, 87 S.Ct., at 1392. As the majority correctly observes, the idea of prohibiting States from taxing "exclusively interstate" transactions had been an important part of our jurisprudence for many decades, ranging intermittently from such cases as *Case of State Freight Tax,* 15 Wall. 232, 279, 21 L.Ed. 146 (1873), through *Freeman v. Hewit,* 329 U.S. 249, 256, 67 S.Ct. 274, 278, 91 L.Ed. 265 (1946), and *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573 (1951). But though it recognizes that *Bellas Hess* was decided amidst an upheaval in our Commerce Clause jurisprudence, in which we began to hold that "a State, with proper drafting, may tax exclusively interstate commerce so long as the tax does not create any effect forbidden by the Commerce Clause," *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 285, 97 S.Ct. 1076, 1082, 51 L.Ed.2d 326 (1977), the majority draws entirely the wrong conclusion from this period of ferment.

The Court attempts to paint *Bellas Hess* in a different hue from *Freeman* and *Spector* because the former "did not rely" on labeling taxes that had "direct" and "indirect" effects on interstate commerce. See *ante,* at 1912. Thus, the Court concludes, *Bellas Hess* "did not automatically fall with *Freeman* *323 and its progeny" in our decision in *Complete Auto. See ante,* at 11. I am unpersuaded by this attempt to distinguish *Bellas Hess* from *Freeman* and Spector, both of which were repudiated by this Court. See *Complete Auto, supra,* at 288-289, and n. 15, 97 S.Ct., at 1084, and n. 15. What we disavowed in *Complete Auto* was not just the "formal distinction between 'direct' and 'indirect' taxes on interstate commerce," *ante,* at 1912, but also the whole notion underlying the *Bellas Hess* physical-presence rule-that "interstate commerce is immune from state taxation," *Complete Auto, supra,* at 288, 97 S.Ct., at 1083.

The Court compounds its misreading by attempting to show that *Bellas Hess* "is not inconsistent with *Complete Auto* and our recent cases." *Ante,* at 1912. This will be news to commentators, who have rightly criticized *Bellas Hess.*[FN1] Indeed, the majority displays no small amount of audacity in claiming that our decision in *National Geographic Society v. California Bd. of Equalization,* 430 U.S. 551, 559, 97 S.Ct. 1386, 1391, 51 L.Ed.2d 631 (1977), which was rendered several weeks after *Complete Auto,* reaffirmed the continuing vitality of *Bellas Hess.* See *ante,* at 1912.

> FN1. See, *e.g.,* P. Hartman, Federal Limitations on State and Local Taxation § 10.8 (1981); Hartman, Collection of Use Tax on Out-of-State Mail-Order Sales, 39 Vand.L.Rev. 993, 1006-1015 (1986); Hellerstein, Significant Sales and Use Tax Developments During the Past Half Century, 39 Vand.L.Rev. 961, 984-985 (1986); McCray, Overturning *Bellas Hess:* Due Process Considerations, 1985 B. Y. U. L. Rev. 265, 288-290; Rothfeld, Mail Order Sales and State Jurisdiction to Tax, 53 Tax Notes 1405, 1414-1418 (1991).

Our decision in that case did just the opposite. *Na-*

tional Geographic held that the National Geographic Society was liable for use tax collection responsibilities in California. **1918 The Society conducted an out-of-state mail-order business similar to the one at issue here and in *Bellas Hess,* and in addition, maintained two small offices in California that solicited advertisements for National Geographic Magazine. The Society argued that its physical presence in California was unrelated to its mail-order sales, and thus that the *324*Bellas Hess* rule compelled us to hold that the tax collection responsibilities could not be imposed. We expressly rejected that view, holding that the "requisite nexus for requiring an out-of-state seller [the Society] to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the State, but simply whether the facts demonstrate 'some definite link, some minimum connection, between (the State and) the *person* ... it seeks to tax.' " 430 U.S., at 561, 97 S.Ct., at 1393 (citation omitted).

By decoupling any notion of a *transactional* nexus from the inquiry, the *National Geographic* Court in fact repudiated the free trade rationale of the *Bellas Hess* majority. Instead, the *National Geographic* Court relied on a due process-type minimum contacts analysis that examined whether a link existed between the seller and the State wholly apart from the seller's in-state transaction that was being taxed. Citations to *Bellas Hess* notwithstanding, see 430 U.S., at 559, 97 S.Ct., at 1391, it is clear that rather than adopting the rationale of *Bellas Hess,* the *National Geographic* Court was instead politely brushing it aside. Even were I to agree that the free trade rationale embodied in *Bellas Hess'* rule against taxes of purely interstate sales was required by our cases prior to 1967, therefore, I see no basis in the majority's opening premise that this substantive underpinning of *Bellas Hess* has not since been disavowed by our cases. [FN2]

FN2. Similarly, I am unconvinced by the majority's reliance on subsequent decisions that have cited *Bellas Hess.* See *ante,* at 1912. In *D. H. Holmes Co. v. McNamara,* 486 U.S. 24, 33, 108 S.Ct. 1619, 1624, 100 L.Ed.2d 21 (1988), for example, we distinguished *Bellas Hess* on the basis of the company's "significant economic presence in Louisiana, its many connections with the State, and the direct benefits it receives from Louisiana in conducting its business." We then went on to note that the situation presented was much more analogous to that in *National Geographic Society v. California Bd. of Equalization,* 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977). See 486 U.S., at 33-34, 108 S.Ct., at 1624-1625. In *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 626, 101 S.Ct. 2946, 2958, 69 L.Ed.2d 884 (1981), the Court cited *Bellas Hess* not to revalidate the physical-presence requirement, but rather to establish that a "nexus" must exist to justify imposition of a state tax. And finally, in *Mobil Oil Corp. v. Commissioner of Taxes of Vt.,* 445 U.S. 425, 437, 100 S.Ct. 1223, 1231, 63 L.Ed.2d 510 (1980), the Court cited *Bellas Hess* for the due process requirements necessary to sustain a tax. In my view, these citations hardly signal the continuing support of *Bellas Hess* that the majority seems to find persuasive.

*325 II

The Court next launches into an uncharted and treacherous foray into differentiating between the "nexus" requirements under the Due Process and Commerce Clauses. As the Court explains: "Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated by different constitutional concerns and policies." *Ante,* at 1913. The due process nexus, which the Court properly holds is met in this case, see *ante,* at Part III, "concerns the fundamental fairness of governmental activity." *Ante,* at 1913. The Commerce Clause nexus requirement, on the other

hand, is "informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." *Ibid.*

Citing *Complete Auto,* the Court then explains that the Commerce Clause nexus requirement is not "like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce." *Ante,* at 1913. This is very curious, because parts two and three ****1919** of the *Complete Auto* test, which require fair apportionment and nondiscrimination in order that interstate commerce not be unduly burdened, now appear to become the animating features of the nexus requirement, which is the first prong of the *Complete Auto* inquiry. The Court freely acknowledges that there is no authority for this novel interpretation of our cases and that we have never before found, as we do in this case, sufficient contacts for due process purposes but an insufficient nexus under the Commerce Clause. See *ante,* at 1913-1914, and n. 6.

The majority's attempt to disavow language in our opinions acknowledging the presence of due process requirements***326** in the *Complete Auto* test is also unpersuasive. See *ante,* at 1913-1914, n. 7 (citing *Trinova Corp. v. Michigan Dept. of Treasury,* 498 U.S. 358, 373, 111 S.Ct. 818, 828, 112 L.Ed.2d 884 (1991)). Instead of explaining the doctrinal origins of the Commerce Clause nexus requirement, the majority breezily announces the rule and moves on to other matters. See *ante,* at 1913-1914. In my view, before resting on the assertion that the Constitution mandates inquiry into two readily distinct "nexus" requirements, it would seem prudent to discern the origins of the "nexus" requirement in order better to understand whether the Court's concern traditionally has been with the fairness of a State's tax or some other value.

The cases from which the *Complete Auto* Court derived the nexus requirement in its four-part test convince me that the issue of "nexus" is really a due process fairness inquiry. In explaining the sources of the four-part inquiry in *Complete Auto,* the Court relied heavily on Justice Rutledge's separate concurring opinion in *Freeman v. Hewit,* 329 U.S. 249, 67 S.Ct. 274, 91 L.Ed. 265 (1946), the case whose majority opinion the *Complete Auto* Court was in the process of comprehensively disavowing. Instead of the formalistic inquiry into whether the State was taxing interstate commerce, the *Complete Auto* Court adopted the more functionalist approach of Justice Rutledge in *Freeman.* See *Complete Auto,* 430 U.S., at 280-281, 97 S.Ct., at 1079-1080. In conducting his inquiry, Justice Rutledge used language that by now should be familiar, arguing that a tax was unconstitutional if the activity lacked a sufficient connection to the State to give "jurisdiction to tax," *Freeman, supra,* at 271, 67 S.Ct., at 286; or if the tax discriminated against interstate commerce; or if the activity was subjected to multiple tax burdens. 329 U.S., at 276-277, 67 S.Ct., at 289-290. Justice Rutledge later refined these principles in *Memphis Natural Gas Co. v. Stone,* 335 U.S. 80, 68 S.Ct. 1475, 92 L.Ed. 1832 (1948), in which he described the principles that the *Complete Auto* Court would later substantially adopt: "[I]t is enough for me to sustain the tax imposed in this case that it is one clearly within the state's power to lay insofar ***327** as any limitation of due process or 'jurisdiction to tax' in that sense is concerned; it is nondiscriminatory ...; [it] is duly apportioned ... ; and cannot be repeated by any other state." 335 U.S., at 96-97, 68 S.Ct., at 1483-1484 (concurring opinion) (footnotes omitted).

By the time the Court decided *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 79 S.Ct. 357, 3 L.Ed.2d 421 (1959), Justice Rutledge was no longer on the Court, but his view of the nexus requirement as grounded in the Due Process Clause was decisively adopted. In rejecting challenges to a state tax based on the Due Process and Commerce Clauses, the Court stated: "[T]he taxes imposed are levied only on that portion of the taxpayer's net income which arises from its activities within the taxing State. These activities form a

sufficient 'nexus between such a tax and transactions within a state for which the tax is an exaction.' " *Id.,* at 464, 79 S.Ct., at 366 (citation omitted). The Court went on to observe that "[i]t strains reality to say, in terms of our decisions, that each of the corporations here was not sufficiently involved in local events to forge 'some definite link, some minimum connection' sufficient to satisfy due process requirements." ****1920** *Id.,* at 464-465, 79 S.Ct., at 366 (quoting *Miller Brothers Co. v. Maryland,* 347 U.S. 340, 344-345, 74 S.Ct. 535, 538-539, 98 L.Ed. 744 (1954)). When the Court announced its four-part synthesis in *Complete Auto,* the nexus requirement was definitely traceable to concerns grounded in the Due Process Clause, and not the Commerce Clause, as the Court's discussion of the doctrinal antecedents for its rule made clear. See *Complete Auto, supra,* at 281-282, 285, 97 S.Ct., at 1080-1081, 1082. For the Court now to assert that our Commerce Clause jurisprudence supports a separate notion of nexus is without precedent or explanation.

Even were there to be such an independent requirement under the Commerce Clause, there is no relationship between the physical-presence/nexus rule the Court retains and Commerce Clause considerations that allegedly justify it. Perhaps long ago a seller's "physical presence" was a sufficient part of a trade to condition imposition of a tax on ***328** such presence. But in today's economy, physical presence frequently has very little to do with a transaction a State might seek to tax. Wire transfers of money involving billions of dollars occur every day; purchasers place orders with sellers by fax, phone, and computer linkup; sellers ship goods by air, road, and sea through sundry delivery services without leaving their place of business. It is certainly true that the days of the door-to-door salesperson are not gone. Nevertheless, an out-of-state direct marketer derives numerous commercial benefits from the State in which it does business. These advantages include laws establishing sound local banking institutions to support credit transactions; courts to ensure collection of the purchase price from the seller's customers; means of waste disposal from garbage generated by mail-order solicitations; and creation and enforcement of consumer protection laws, which protect buyers and sellers alike, the former by ensuring that they will have a ready means of protecting against fraud, and the latter by creating a climate of consumer confidence that inures to the benefit of reputable dealers in mail-order transactions. To create, for the first time, a nexus requirement under the Commerce Clause independent of that established for due process purposes is one thing; to attempt to justify an anachronistic notion of physical presence in economic terms is quite another.

III

The illogic of retaining the physical-presence requirement in these circumstances is palpable. Under the majority's analysis, and our decision in *National Geographic,* an out-of-state seller with one salesperson in a State would be subject to use tax collection burdens on its entire mail-order sales even if those sales were unrelated to the salesperson's solicitation efforts. By contrast, an out-of-state seller in a neighboring State could be the dominant business in the putative taxing State, creating the greatest infrastructure burdens and undercutting the State's home companies by its comparative***329** price advantage in selling products free of use taxes, and yet not have to collect such taxes if it lacks a physical presence in the taxing State. The majority clings to the physical-presence rule not because of any logical relation to fairness or any economic rationale related to principles underlying the Commerce Clause, but simply out of the supposed convenience of having a bright-line rule. I am less impressed by the convenience of such adherence than the unfairness it produces. Here, convenience should give way. Cf. *Complete Auto, supra,* at 289, n. 15, 97 S.Ct., at 1084 n. 15 ("We believe, however, that administrative convenience ... is insufficient justification for abandoning the principle that 'interstate commerce may be made to pay its way' ").

Also very questionable is the rationality of perpetuating a rule that creates an interstate tax shelter for one form of business-mail-order sellers-but no countervailing advantage for its competitors. If the Commerce **1921 Clause was intended to put businesses on an even playing field, the majority's rule is hardly a way to achieve that goal. Indeed, arguably even under the majority's explanation for its "Commerce Clause nexus" requirement, the unfairness of its rule on retailers other than direct marketers should be taken into account. See *ante,* at 1913 (stating that the Commerce Clause nexus requirement addresses the "structural concerns about the effects of state regulation on the national economy"). I would think that protectionist rules favoring a $180-billion-a-year industry might come within the scope of such "structural concerns." See Brief for State of New Jersey as *Amicus Curiae* 4.

IV

The Court attempts to justify what it rightly acknowledges is an "artificial" rule in several ways. See *ante,* at 1914. First, it asserts that the *Bellas Hess* principle "firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes." *Ante,* at 1915. It is very doubtful, *330 however, that the Court's opinion can achieve its aims. Certainly our cases now demonstrate two "bright-line" rules for mail-order sellers to follow: Under the physical-presence requirement reaffirmed here, they will not be subjected to use tax collection if they have no physical presence in the taxing State; under the *National Geographic* rule, mail-order sellers will be subject to use tax collection if they have some presence in the taxing State even if that activity has no relation to the transaction being taxed. See *National Geographic,* 430 U.S., at 560-562, 97 S.Ct., at 1392-1393. Between these narrow lines lies the issue of what constitutes the requisite "physical presence" to justify imposition of use tax collection responsibilities.

Instead of confronting this question head on, the majority offers only a cursory analysis of whether Quill's physical presence in North Dakota was sufficient to justify its use tax collection burdens, despite briefing on this point by the State.[FN3] See Brief for Respondent 45-47. North Dakota contends that even should the Court reaffirm the *Bellas Hess* rule, Quill's physical presence in North Dakota was sufficient to justify application of its use tax collection law. Quill concedes it owns software sent to its North Dakota customers, but suggests that such property is insufficient to justify a finding of nexus. In my view, the question of Quill's actual physical presence is sufficiently close to cast doubt on the majority's confidence that it is propounding a truly "bright-line" rule. Reasonable minds surely can, and will, differ over what showing is required to make out a "physical presence" *331 adequate to justify imposing responsibilities for use tax collection. And given the estimated loss in revenue to States of more than $3.2 billion this year alone, see Brief for Respondent 9, it is a sure bet that the vagaries of "physical presence" will be tested to their fullest in our courts.

> FN3. Instead of remanding for consideration of whether Quill's ownership of software constitutes sufficient physical presence under its new Commerce Clause nexus requirement, the majority concludes as a matter of law that it does not. See *ante,* at 1914, n. 8. In so doing, the majority rebuffs North Dakota's challenge without setting out any clear standard for what meets the Commerce Clause physical-presence nexus standard and without affording the State an opportunity on remand to attempt to develop facts or otherwise to argue that Quill's presence is constitutionally sufficient.

The majority next explains that its "bright-line" rule encourages "settled expectations" and business investment. *Ante,* at 1914-1915. Though legal certainty promotes business confidence, the mail-order business has grown exponentially despite the long

line of our post- *Bellas Hess* precedents that signaled the demise of the physical-presence requirement. Moreover, the Court's seeming but inadequate justification of encouraging settled expectations in fact connotes a substantive economic decision to favor out-of-state direct marketers to the detriment of **1922 other retailers. By justifying the *Bellas Hess* rule in terms of "the mail-order industry's dramatic growth over the last quarter century," *ante,* at 1915, the Court is effectively imposing its own economic preferences in deciding this case. The Court's invitation to Congress to legislate in this area signals that its preferences are not immutable, but its approach is different from past instances in which we have deferred to state legislatures when they enacted tax obligations on the States' shares of interstate commerce. See, *e.g., Goldberg v. Sweet,* 488 U.S. 252, 109 S.Ct. 582, 102 L.Ed.2d 607 (1989); *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 101 S.Ct. 2946, 69 L.Ed.2d 884 (1981).

Finally, the Court accords far greater weight to *stare decisis* than was given to that principle in *Complete Auto* itself. As that case demonstrates, we have not been averse to overruling our precedents under the Commerce Clause when they have become anachronistic in light of later decisions. See *Complete Auto,* 430 U.S., at 288-289, 97 S.Ct., at 1083-1084. One typically invoked rationale for *stare decisis*-an unwillingness to upset settled expectations-is particularly weak in this case. It is unreasonable for companies such as Quill to invoke a "settled expectation" in conducting affairs without being taxed. Neither Quill nor any of its *amici* point to any investment decisions*332 or reliance interests that suggest any unfairness in overturning *Bellas Hess.* And the costs of compliance with the rule, in light of today's modern computer and software technology, appear to be nominal. See Brief for Respondent 40; Brief for State of New Jersey as *Amicus Curiae* 18. To the extent Quill developed any reliance on the old rule, I would submit that its reliance was unreasonable because of its failure to comply with the law as enacted by the North Dakota State Legislature. Instead of rewarding companies for ignoring the studied judgments of duly elected officials, we should insist that the appropriate way to challenge a tax as unconstitutional is to pay it (or in this case collect it and remit it or place it in escrow) and then sue for declaratory judgment and refund.[FN4] Quill's refusal to comply with a state tax statute prior to its being held unconstitutional hardly merits a determination that its reliance interests were reasonable.

> FN4. For the federal rule, see *Flora v. United States,* 357 U.S. 63, 78 S.Ct. 1079, 2 L.Ed.2d 1165 (1958); see generally J. Mertens, Law of Federal Income Taxation § 58A.05 (1992). North Dakota appears to follow the same principle. See *First Bank of Buffalo v. Conrad,* 350 N.W.2d 580, 586 (N.D.1984) (citing 72 Am.Jur.2d § 1087).

The Court hints, but does not state directly, that a basis for its invocation of *stare decisis* is a fear that overturning *Bellas Hess* will lead to the imposition of retroactive liability. *Ante,* at 1916, and n. 10. See *James B. Beam Distilling Co. v. Georgia,* 501 U.S. 529, 111 S.Ct. 2439, 115 L.Ed.2d 481 (1991). As I thought in that case, such fears are groundless because no one can "sensibly insist on automatic retroactivity for any and all judicial decisions in the federal system." *Id.,* at 546, 111 S.Ct., at 2449 (WHITE, J., concurring in judgment). Since we specifically limited the question on which certiorari was granted in order *not* to consider the potential retroactive effects of overruling *Bellas Hess,* I believe we should leave that issue for another day. If indeed fears about retroactivity are driving the Court's decision in this case, we would be better served, in my view, to address *333 those concerns directly rather than permit them to infect our formulation of the applicable substantive rule.

Although Congress can and should address itself to this area of law, we should not adhere to a decision, however right it was at the time, that by reason of later cases and economic reality can no longer be rationally justified. The Commerce Clause aspect of

Bellas Hess, along with its due process holding, should be overruled.

**1923 Justice SCALIA, with whom Justice KENNEDY and Justice THOMAS join, concurring in part and concurring in the judgment.

National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), held that the Due Process and Commerce Clauses of the Constitution prohibit a State from imposing the duty of use-tax collection and payment upon a seller whose only connection with the State is through common carrier or the United States mail. I agree with the Court that the Due Process Clause holding of *Bellas Hess* should be overruled. Even before *Bellas Hess,* we had held, correctly I think, that state regulatory jurisdiction could be asserted on the basis of contacts with the State through the United States mail. See *Travelers Health Assn. v. Virginia ex rel. State Corp. Comm'n,* 339 U.S. 643, 646-650, 70 S.Ct. 927, 928-931, 94 L.Ed. 1154 (1950) (blue sky laws). It is difficult to discern any principled basis for distinguishing between jurisdiction to regulate and jurisdiction to tax. As an original matter, it might have been possible to distinguish between jurisdiction to tax and jurisdiction to compel collection of taxes as agent for the State, but we have rejected that. *National Geographic Society v. California Bd. of Equalization,* 430 U.S. 551, 558, 97 S.Ct. 1386, 1391, 51 L.Ed.2d 631 (1977); *Scripto, Inc. v. Carson,* 362 U.S. 207, 211, 80 S.Ct. 619, 621, 4 L.Ed.2d 660 (1960). I agree with the Court, moreover, that abandonment of *Bellas Hess*' due process holding is compelled by reasoning "[c]omparable" to that contained in our post-1967 cases dealing with state jurisdiction to adjudicate. *Ante,* at 1911. I do not understand this to mean that the due process standards for *320 adjudicative jurisdiction and those for legislative (or prescriptive) jurisdiction are necessarily identical; and on that basis I join Parts I, II, and III of the Court's opinion. Compare *Asahi Metal Industry Co. v. Superior Court of Cal., Solano Cty.,* 480 U.S. 102, 107 S.Ct. 1026, 94 L.Ed.2d 92 (1987), with *American Oil Co. v. Neill,* 380 U.S. 451, 85 S.Ct. 1130, 14 L.Ed.2d 1 (1965).

I also agree that the Commerce Clause holding of *Bellas Hess* should not be overruled. Unlike the Court, however, I would not revisit the merits of that holding, but would adhere to it on the basis of *stare decisis. American Trucking Assns., Inc. v. Smith,* 496 U.S. 167, 204, 110 S.Ct. 2323, 2345, 110 L.Ed.2d 148 (1990) (SCALIA, J., concurring in judgment). Congress has the final say over regulation of interstate commerce, and it can change the rule of *Bellas Hess* by simply saying so. We have long recognized that the doctrine of *stare decisis* has "special force" where "Congress remains free to alter what we have done." *Patterson v. McLean Credit Union,* 491 U.S. 164, 172-173, 109 S.Ct. 2363, 2370, 105 L.Ed.2d 132 (1989). See also *Hilton v. South Carolina Public Railways Comm'n,* 502 U.S. 197, 202, 112 S.Ct. 560, 564, 116 L.Ed.2d 560 (1991); *Illinois Brick Co. v. Illinois,* 431 U.S. 720, 736, 97 S.Ct. 2061, 2069, 52 L.Ed.2d 707 (1977). Moreover, the demands of the doctrine are "at their acme ... where reliance interests are involved." *Payne v. Tennessee,* 501 U.S. 808, 828, 111 S.Ct. 2597, 2610, 115 L.Ed.2d 720 (1991). As the Court notes, "the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizable industry." *Ante,* at 1916.

I do not share Justice WHITE's view that we may disregard these reliance interests because it has become unreasonable to rely upon *Bellas Hess. Post,* at 1922. Even assuming for the sake of argument (I do not consider the point) that later decisions in related areas are inconsistent with the principles upon which *Bellas Hess* rested, we have never acknowledged that, but have instead carefully distinguished the case on its facts. See, *e.g., D.H. Holmes Co. v. McNamara,* 486 U.S. 24, 33, 108 S.Ct. 1619, 1624, 100 L.Ed.2d 21 (1988); *National Geographic Society, supra,* 430 U.S., at 559, 97 S.Ct., at 1391. It seems to me important that we retain our ability-and, what comes to the **1924 same thing, that we maintain public confidence in our ability-some-

times to adopt new principles for the resolution of new issues without abandoning clear holdings of the past that those principles contradict. We seemed to be doing that in this area. Having affirmatively suggested that the "physical presence" rule could be reconciled with our new jurisprudence, we ought not visit economic hardship upon those who took us at our word. We have recently told lower courts that "[i]f a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [they] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions." *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484, 109 S.Ct. 1917, 1921, 104 L.Ed.2d 526 (1989). It is strangely incompatible with this to demand that private parties anticipate our overrulings. It is my view, in short, that reliance upon a square, unabandoned holding of the Supreme Court is *always* justifiable reliance (though reliance alone may not always carry the day). Finally, the "physical presence" rule established in *Bellas Hess* is not "unworkable," *Patterson, supra* 491 U.S., at 173, 109 S.Ct., at 2370, to the contrary, whatever else may be the substantive pros and cons of the rule, the "bright-line" regime that it establishes, see *ante,* at 1914-1915, is unqualifiedly in its favor. Justice WHITE's concern that reaffirmance of *Bellas Hess* will lead to a flurry of litigation over the meaning of "physical presence," see *post,* at 1921, seems to me contradicted by 25 years of experience under the decision.

For these reasons, I concur in the judgment of the Court and join Parts I, II, and III of its opinion.

U.S.N.D.,1992.
Quill Corp. v. North Dakota By and Through Heitkamp
504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91, 60 USLW 4423

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Court of Appeals of New York.
In the Matter of ORVIS COMPANY, INC., Respondent-Appellant,
v.
TAX APPEALS TRIBUNAL OF the STATE OF NEW YORK et al., Respondents,
and
Commissioner of the New York State Department of Taxation and Finance, Appellant-Respondent.
In the Matter of VERMONT INFORMATION PROCESSING, INC., Respondent,
v.
TAX APPEALS TRIBUNAL OF the STATE OF NEW YORK, Respondent,
and
Commissioner of Taxation and Finance of the State of New York, Appellant.
June 14, 1995.
Certiorari Denied Nov. 27, 1995.
See 116 S.Ct. 518.

Mail order vendor filed Article 78 proceeding to review determination of Tax Appeals Tribunal sustaining sales and use tax assessment. The Supreme Court, Appellate Division, White, J., 204 A.D.2d 916, 612 N.Y.S.2d 503, held that vendor was immunized from duty to collect compensating use taxes. State appealed. In a second case, a computer distributor initiated a similar proceeding. The Supreme Court, Appellate Division, Yesawich, J., 206 A.D.2d 764, 615 N.Y.S.2d 99, also held that vendor was immunized from duty to collect sales and use taxes. State appealed. The Court of Appeals, Levine, J., held that: (1) in order to impose duty on out-of-state vendors to collect compensating use taxes from their in-state customers, physical presence of vendors was required, which did not have to be substantial but had to be demonstrably more than "slightest presence," and (2) activity of out-of-state vendors was sufficient to impose obligation on vendors to collect sales and use taxes.

Ordered accordingly.

Bellacosa, J., dissented and filed opinion in which Ciparick, J., joined.

West Headnotes

[1] Commerce 83 ⚿74.5(1)

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k74.5 Sales and Use Taxes
83k74.5(1) k. In General. Most Cited Cases
While physical presence of out-of-state vendor in taxing state is required in order to impose duty on vendor to collect compensating use tax without contravening commerce clause, physical presence need not be substantial but, rather, it must be demonstrably more than slightest presence; physical presence may be manifested by presence in taxing state of vendor's property or conduct of economic activities in taxing state performed by vendor's personnel or on its behalf. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[2] Commerce 83 ⚿74.5(2)

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(E) Licenses and Taxes
83k74.5 Sales and Use Taxes
83k74.5(2) k. Particular Subjects and Transactions. Most Cited Cases

Taxation 371 ⚿3670

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(D) Persons Subject to or Liable for Tax
371k3670 k. Nonresidents and Foreign Corporations. Most Cited Cases
(Formerly 371k1270)
Activity of out-of-state vendor was sufficient to impose obligation on vendor to collect compensating use taxes on vendor's taxable retail sales to in-state customers, which occurred almost entirely through mail-order catalog sales, in view of evidence that

vendor's sales revenues to in-state customers ranged from $1 million to $1.5 million and that some salesmen traveled to state to directly solicit retailers. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[3] Taxation 371 3693

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(G) Levy and Assessment
371k3690 Evidence
371k3693 k. Weight and Sufficiency. Most Cited Cases
(Formerly 371k1317)
Determination that affidavits of president and treasurer of out-of-state vendor, which averred that salespersons' visits to state were not for purpose of promotion, lacked credibility, for purposes of determining whether vendor had sufficient physical presence in state to justify imposition of duty on vendor to collect compensating use taxes, was supported by evidence that vendor declined to expose its president and treasurer to cross-examination by producing them at hearing and that description of purposes of visits was inconsistent with admissions against interest contained in vendor's initial response to inquiry of taxing authorities. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[4] Taxation 371 3694

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(G) Levy and Assessment
371k3694 k. Administrative Review. Most Cited Cases
(Formerly 371k1318)
Regulations of State Department of Taxation and Finance that authorize submission of affidavits in lieu of oral testimony do not prevent Tax Appeals Tribunal from rejecting credibility of affidavits submitted. N.Y. Comp. Codes R. & Regs. title 20, § 3000.10(d)(1).

[5] Taxation 371 3670

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(D) Persons Subject to or Liable for Tax
371k3670 k. Nonresidents and Foreign Corporations. Most Cited Cases
(Formerly 371k1270)
Activity of out-of-state vendor of computer software and hardware was sufficient to impose obligation on vendor to collect sales and use taxes on vendor's taxable retail sales to in-state customers, in view of evidence that vendor made trouble-shooting visits to state customers and that these visits enhanced sales and significantly contributed to vendor's ability to establish market for software and hardware. U.S.C.A. Const. Art. 1, § 8, cl. 3.

***681 *167 **955** Dennis C. Vacco, Attorney-General, Albany (Daniel Smirlock, Jerry Boone and Peter H. Schiff, of counsel), for appellant-respondent in the first above-entitled proceeding.

Brann & Isaacson, Lewiston, ME (George S. Isaacson and David W. Bertoni, of the Maine Bar, admitted pro hac vice, of counsel), and Hodgson, Russ, Andrews, Woods & Goodyear, Buffalo (Paul R. Comeau and Robert D. Plattner, of counsel), for respondent-appellant in the first above-entitled proceeding.

***168** Dennis C. Vacco, Albany (Daniel Smirlock, Jerry Boone, Peter H. Schiff and Victoria A. Graffeo, of counsel), for appellant in the second above-entitled proceeding.

DeGraff, Foy, Holt-Harris, Mealey & Kunz, Albany (James H. Tully, Jr., and Peter G. Barber, of counsel), for Vermont Information Processing, Inc., respondent in the second above-entitled proceeding.

***169** Alan Friedman and June T. Summers, Washington, DC, of the District of Columbia Bar, admitted pro hac vice, for Multistate Tax Com'n, amicus curiae in the first and second above-entitled proceedings.

OPINION OF THE COURT

LEVINE, Judge.

On these appeals, the State Commissioner of Taxation and Finance seeks to overturn two decisions of the Appellate Division [FN1] holding that Vermont vendors of products purchased by New Yorkers for use in this State were immunized from the duty to collect State compensating use taxes (Tax Law § 1110) under the Commerce Clause (U.S. Const., art. I, § 8) of the

Federal Constitution. Petitioner Orvis Company, Inc. (Orvis) sells, at both retail and wholesale, camping, fishing and hunting equipment, casual and outdoor clothing and food and various gift items. Orvis' retail sales were almost entirely through mail-order catalog purchases shipped from Vermont by common carrier or the United States mail. Orvis also sold merchandise at wholesale to New York retail establishments. Concededly, Orvis employees visited New York retailers to whom it sold merchandise during the three-year audit period.

> FN1. *Matter of Orvis Co. v. Tax Appeals Tribunal,* 204 A.D.2d 916, 612 N.Y.S.2d 503; *Matter of Vermont Information Processing v. Tax Appeals Tribunal,* 206 A.D.2d 764, 615 N.Y.S.2d 99.

Relying upon *Quill Corp. v. North Dakota,* 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91, the Appellate Division held that in the absence of a substantial physical presence by Orvis personnel in New York, the imposition of the duty to collect use taxes from its New York mail-order***170** purchasers contravened the Commerce Clause. The Court concluded that Orvis' "sporadic activities in New York" failed to meet the substantial physical presence standard and, therefore, the assessment of the tax was invalid (204 A.D.2d, at 918, 612 N.Y.S.2d 503).

Petitioner Vermont Information Processing, Inc. (VIP) markets computer software and hardware to beverage distributors in New York and elsewhere throughout the United States. In most instances, its customers' orders were filled through shipments by common carrier or United States mail. An audit of VIP's invoices and sales records, *****682 **956** however, showed visits by its employees to New York customers to resolve problems and give additional instructions in connection with the use of VIP software programs, and occasionally for installing software. The Appellate Division again concluded that those activities were insufficient to constitute the requisite substantial physical presence of VIP in this State and annulled the determination assessing the tax.

We do not read *Quill Corp. v. North Dakota* to make a *substantial* physical presence of an out-of-State vendor in New York a prerequisite to imposing the duty upon the vendor to collect the use tax from its New York clientele. The Appellate Division erroneously applied that exacting standard in both cases.

I.

The true holding of *Quill Corp. v. North Dakota* can best be understood by considering the case in the context of its position in the evolution of Supreme Court doctrine limiting the authority of a State to assess or impose a duty to collect taxes arising out of the economic activity of a foreign business engaged in interstate commerce. The constitutional limitations on such authority have been derived from two sources. The first is the Due Process Clause of the Fourteenth Amendment of the U.S. Constitution, pertaining to the jurisdiction to tax, or the "taxing power", of a State (*Wisconsin v. Penney Co.,* 311 U.S. 435, 445, 61 S.Ct. 246, 250, 85 L.Ed. 267). The second source is the so-called "dormant" or "negative" Commerce Clause, by virtue of which the constitutional grant of power to Congress "[t]o regulate commerce * * * among the several States" (U.S. Const., art. I, § 8, cl. [3]) has been interpreted as implicitly prohibiting, even in the absence of Congressional regulation, unduly burdensome or discriminatory State taxation of transactions or entities engaged***171** in interstate commerce (*see, Oklahoma Tax Commn. v. Jefferson Lines,* 514 U.S. 175, ---- - ----, 115 S.Ct. 1331, 1335-1336, 131 L.Ed.2d 261; *Quill Corp. v. North Dakota,* 504 U.S., at 309, 112 S.Ct. at 1911, *supra*).

Under its Due Process Clause analysis, the Supreme Court has fashioned a requirement that, for a State to validly tax an interstate commercial activity, there must be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax" (*Miller Bros. Co. v. Maryland,* 347 U.S. 340, 344-345, 74 S.Ct. 535, 538, 98 L.Ed. 744; *see, Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 272, 98 S.Ct. 2340, 2343, 57 L.Ed.2d 197).

As to Commerce Clause challenges, one strand of earlier cases applied a formalistic approach prohibiting the imposition of what the Court deemed a "direct" tax on interstate commerce (*see, Spector Motor Serv. v. O'Connor,* 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573; *Freeman v. Hewit,* 329 U.S. 249, 67 S.Ct. 274, 91 L.Ed. 265). Except for such taxes found to directly burden interstate commerce, the Court recognized that the Commerce Clause did not "relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing

the business" (*Western Live Stock v. Bureau,* 303 U.S. 250, 254, 58 S.Ct. 546, 548, 82 L.Ed. 823). Accordingly, other forms of nondiscriminatory taxation on interstate transactions were permitted. A nexus was required, however, between the taxing State and the entity, property or activity it sought to tax.

Little difficulty was encountered in finding the required local nexus with respect to sales and compensating use taxes. In *McGoldrick v. Berwind-White Co.,* 309 U.S. 33, 60 S.Ct. 388, 84 L.Ed. 565, the vendor's responsibility to collect the tax on the sale of coal by a Pennsylvania producer to a New York City purchaser was upheld because "the tax is conditioned upon a *local activity,* delivery of goods within the state upon their purchase for consumption" (*id.,* at 58, 60 S.Ct. at 398 [emphasis supplied]).

Until *Quill Corp. v. North Dakota,* the constitutionally required nexus between the taxing State and the activity, entity or property subject to the tax was applied indistinguishably for purposes of both Due Process and Commerce Clause analysis, i.e., a definite link or minimum connection (*see, National Bellas Hess v. Department of Revenue,* 386 U.S. 753, 756-757, 87 S.Ct. 1389, 1391, 18 L.Ed.2d 505; *Scripto v. Carson,* 362 ***683 **957 U.S. 207, 210-211, 80 S.Ct. 619, 621, 4 L.Ed.2d 660). Some physical presence of the vendor in the taxing State was noted as a factor justifying the imposition of the sales and use tax collection obligation. In *Felt & Tarrant Co. v. Gallagher,* 306 U.S. 62, 59 S.Ct. 376, 83 L.Ed. 488 that presence was found in the foreign seller's engagement of two *172 nonemployee, commissioned sales agents to solicit orders and the rental of office space for them. In *Scripto v. Carson (supra),* 10 wholly commissioned, nonemployee, "advertising specialty brokers" (*id.,* at 209, 80 S.Ct. at 620), retained on a part-time, nonexclusive basis to solicit sales, constituted a sufficient physical connection.

In *National Bellas Hess v. Department of Revenue,* 386 U.S. 753, 87 S.Ct. 1389, *supra,* the Court for the first time explicitly made some physical presence of the vendor in the taxing State a requirement under both the Commerce and Due Process Clauses for charging the vendor with the duty of collecting a use tax on mail-order purchases by residents of that State. Physical presence within the taxing State was required, irrespective of the degree to which the vendor may have availed itself of the benefits and protection of the taxing State in other ways, such as by "regularly and continuously engag[ing] in 'exploitation of the consumer market' of [that State]" (*id.,* at 762, 87 S.Ct., at 1394 [Fortas, J., dissenting] [quoting *Miller Bros. Co. v. Maryland, supra*]). In *Bellas Hess,* the vendor's patronage in the taxing State was exclusively through mail-order purchases, and its only contact with its customers was by way of the United States mails or by common carrier.

The Court in *Bellas Hess* gave three reasons for requiring the vendor's physical presence in the taxing State: (1) without some physical presence, there would be no fair basis for making interstate commerce bear a share of the cost of local government; (2) a contrary rule would require the Court "to repudiate *totally* the *sharp* distinction", relied upon by State taxing authorities, between mail-order sellers with local outlets or solicitors and "those *who do no more* than communicate with customers in the State by mail or common carrier as part of a general interstate business" (386 U.S., at 758, 87 S.Ct., at 1392 [emphasis supplied]); and (3) permitting imposition of the duty of collection of the tax in that case would subject national mail-order businesses to oppressive administrative and record-keeping burdens "in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose 'a fair share of the cost of the local government' " (*id.,* at 759-760, 87 S.Ct., at 1392-1393).

As reflected in the cases following *Bellas Hess,* the requirement of the vendor's physical presence in the taxing State was not unduly exacting. In *Standard Steel Co. v. Washington Revenue Dept.,* 419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719, the Court upheld the assessment of a Washington State gross receipts tax on a foreign vendor's *173 sales to the Boeing Company against Due Process and Commerce Clause challenges. The Court found a sufficient vendor's physical presence in the State to justify the tax in the person of a single resident engineer-employee who operated out of his home in Seattle and whose responsibilities were to consult with Boeing on anticipated needs for the vendor's parts in Boeing's aircraft manufacturing process and to follow up on shipping or other problems in using the vendor's product (*id.,* at 562-563, 95 S.Ct., at 708-709). In *Goldberg v. Sweet,* 488 U.S. 252,, 109 S.Ct. 582, 102 L.Ed.2d 607, at issue was Illinois' imposition of a 5% excise tax on interstate telephone calls which the taxing statute required to be

collected by long-distance telephone carriers, such as GTE Sprint Communications (Sprint), through their billings. Sprint challenged the tax, but it and the other parties did not contest (and the Court agreed) that the local nexus requirement was met because the tax was restricted to telephone calls originating or terminating in Illinois and charged to an Illinois service address (*id.*, at 263, 109 S.Ct., at 589). In concluding that a sufficient local nexus existed, the Court did not inquire further into the extent of Sprint's physical presence in the State.

Two other decisions are significant for their articulation of the criteria to determine whether a given tax imposed on interstate ***684 **958** commercial activity passes constitutional muster under the Commerce Clause. In *Complete Auto Tr. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326, the Court repudiated the artificial and confusing formalistic distinction between direct and indirect taxes on interstate commerce, and overruled *Spector Motor Serv. v. O'Connor (supra)* and *Freeman v. Hewit (supra).* It explicitly confirmed its agreement with the approach of the alternative line of decisions (some of which we have discussed), such as *Western Live Stock v. Bureau,* 303 U.S. 250, 58 S.Ct. 546, *supra.* The Court characterized those decisions as having "considered * * * [the] practical effect [of the taxing statute] and * * * sustained [the] tax * * * when the tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State" (430 U.S., at 279, 97 S.Ct., at 1079). The *Complete Auto* articulation of the four-pronged standard for determining the validity of a State tax on interstate commercial activity under the dormant Commerce Clause remains the prevailing test, with refinements, to this day (*see, Oklahoma Tax Commn. v. Jefferson Lines,* 514 U.S., at ----, 115 S.Ct., at 1337, *supra*).

One such refinement of *Complete Auto* was made at the *174 same term in *National Geographic v. California Equalization Bd.,* 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631. There the Court upheld a use tax collection obligation with respect to interstate mail-order sales of the Society from its District of Columbia home office, on the basis of the physical presence of two National Geographic magazine advertising sales offices in the taxing State. The Court made two significant rulings: (1) the required nexus with the taxing State need *not* necessarily be directly related to the activity being taxed, "but [could] simply [be] whether the facts demonstrate 'some definite link, some minimum connection, between [the taxing State and] the *person* ... it seeks to tax' " (*id.,* at 561, 97 S.Ct., at 1393 [quoting *Miller Bros. Co. v. Maryland, supra*] [emphasis in original]); and (2) the required physical presence of the vendor in the taxing State must be more than the " 'slightest presence' " (*id.,* at 556, 97 S.Ct., at 1390).

II.

It is with the foregoing decisional evolution of negative Commerce Clause doctrine by the Supreme Court in mind that we turn to *Quill Corp. v. North Dakota,* 504 U.S. 298, 112 S.Ct. 1904, *supra, Quill Corp.,* like *National Bellas Hess,* involved a vendor exclusively engaged in a mail-order business with substantial patronage in the taxing State, but whose only connection with its customers in that State was by common carrier or the United States mail. The Supreme Court of North Dakota held, nonetheless, that social, technological, economic, commercial and legal changes since *Bellas Hess* was decided rendered the holding in that case obsolete. The North Dakota court concluded that physical presence was no longer necessary in the case of a mail-order vendor who systematically directed its marketing efforts at the taxing State. The State Supreme Court pointed out that North Dakota had expended significant resources to create and nurture an economic climate supporting a demand for Quill's products, had provided a legal infrastructure that protected and secured Quill's financial interests, and had disposed as waste many tons of Quill's catalogs and promotional materials mailed to the State. Therefore, the North Dakota Supreme Court reasoned, the Commerce Clause should not bar making Quill pay its fair share for those benefits and protections it received from the State. The United States Supreme Court noted that it was thus confronted with a pull in one direction from the approach emphasized in *Complete Auto Tr.* adjudging a State tax *175 for Commerce Clause purposes based upon economic realities and practical effects, and the opposing magnetism of stare decisis. "Having granted certiorari * * * we must either reverse the State Supreme Court or overrule *Bellas Hess. While we agree with much of the State Court's reasoning,* we take the former course" (504 U.S., at 301-302, 112 S.Ct., at 1907 [emphasis supplied]).

In actuality, however, the Supreme Court in *Quill* adopted a middle course. It overruled so much of *Bellas Hess* as required ***685 **959 some physical presence of the vendor as a "minimum connection" in the taxing State to support the jurisdiction to tax under the Due Process Clause (504 U.S., at 306, 307-308, 112 S.Ct., at 1909, 1910).[FN2] However, the Supreme Court in *Quill* elected to adhere to the *Bellas Hess* precedent requiring some physical presence of an interstate mail-order vendor in the taxing State for validity under the Commerce Clause. This course was not adopted without some apparent reluctance. Thus, the Court stated that, "[w]hile contemporary Commerce Clause jurisprudence *might not dictate the same result were the issue to arise for the first time today, Bellas Hess* is not inconsistent with *Complete Auto* " (504 U.S., at 311, 112 S.Ct., at 1912). It further stated, "*[a]lthough we agree with the state court's assessment* of the evolution of our cases, we do not share its conclusion that this evolution indicates that the Commerce Clause ruling of *Bellas Hess* is no longer good law" (504 U.S., at 314, 112 S.Ct., at 1914 [emphasis supplied]).

> FN2. Because minimum physical presence in the taxing State is no longer required to support jurisdiction to tax under the Due Process Clause, the authority of *Miller Bros. Co. v. Maryland,* 347 U.S. 340, 74 S.Ct. 535, 98 L.Ed. 744, a pure due process case-heavily relied upon by the dissent-is considerably weakened.

The rationale of the Supreme Court in *Quill* for continuing to require the physical presence of the vendor in the taxing State, however, was *not* the same primarily relied upon in *Bellas Hess,* that only by requiring a physical presence in the taxing State can the vendor justifiably be called upon to pay its fair share of the cost of local government. The Supreme Court agreed with the North Dakota Supreme Court's conclusion that, under the more "flexible" approach of current Commerce Clause jurisprudence (504 U.S., at 314, 112 S.Ct., at 1914), the *quid pro quo* for State taxation could be found in the benefits and protections the State confers in providing for a stable and secure legal-economic environment for a mail-order vendor's substantial marketing efforts aimed at the taxing State. Rather, the justification for continuing to require a physical presence of the vendor in the taxing State was based on two *176 other grounds. First, *Bellas Hess* furthers the ends of the Commerce Clause by furnishing a " 'bright-line' test[ ]" (504 U.S., at 314, 112 S.Ct., at 1914), a "demarcation of a discrete realm of commercial activity that is free from interstate taxation" (*id.,* at 315, 112 S.Ct., at 1914). The *Bellas Hess* rule, thus, serves to assure tax immunity to "vendors 'whose *only connection* with customers in the [taxing] State is by common carrier or the United States mail' " (*id.,* at 315, 112 S.Ct., at 1914 [emphasis supplied]). Such a bright-line demarcation benefits national commerce by avoiding the litigation-provoking controversy and confusion of imprecise constitutional standards, and fosters investment by settling expectations *(id.).* Second, adherence to the *Bellas Hess* physical presence requirement satisfies the especially applicable demands of stare decisis. "[T]he *Bellas Hess* rule has engendered substantial reliance and has become part of a basic framework of a sizable industry. The 'interest in stability and orderly development of the law' that undergirds the doctrine of stare decisis * * * therefore counsels adherence to settled precedent" (504 U.S., at 317, 112 S.Ct., at 1916).

III.

As the foregoing discussion demonstrates, both the literal language of the *Quill* decision and consideration of its place in the evolution of Supreme Court Commerce Clause jurisprudence refute the Appellate Division's conclusion, urged by Orvis and VIP here, that "*Quill* * * * *increased* the requisite threshold of in-State physical presence from any measurable amount of in-State people or property to *substantial amounts* of in-State people or property" (204 A.D.2d, at 917, 612 N.Y.S.2d 503 [emphasis supplied]). *Quill* simply cannot be read as equating a substantial physical presence of the vendor in the taxing State with the substantial nexus prong of the *Complete Auto* test, as the Appellate Division's interpretation would require.

First, neither in *Bellas Hess* nor in the cases preceding it, or succeeding it up to *Quill* did the Court express any insistence that the physical presence of the interstate vendor be substantial for a valid taxation of ***686 **960 sales of or imposition of a use tax collection duty upon the vendor. *Bellas Hess* itself, in requiring the vendor's physical presence, explicitly stated that it was applying a definite link or minimum connection requirement, which was the then prevailing nexus standard for both Due Process and Com-

merce Clause analysis in interstate commerce taxation cases (*see,* 386 U.S., at 756-757, 87 S.Ct., at 1391, *supra*). *177 Surely as a matter of simple logic and semantics, the Supreme Court was not applying a *substantial* physical presence requirement when it upheld the State tax on the in-State activity of the interstate vendor in the following cases: *Felt & Tarrant Co. v. Gallagher,* 306 U.S. 62, 59 S.Ct. 376, *supra* (two nonemployee, commissioned sales solicitors); *Scripto v. Carson,* 362 U.S. 207, 80 S.Ct. 619, *supra* (10 part-time, nonemployee, nonexclusive, commissioned sales brokers); *Standard Steel Co. v. Washington Revenue Dept.,* 419 U.S. 560, 95 S.Ct. 706, *supra* (one engineer-consultant operating an office out of his home); *Goldberg v. Sweet,* 488 U.S. 252, 109 S.Ct. 582, *supra* (an interstate long-distance telephone carrier's billing to an in-State service address for calls originating or terminating in the taxing State).

As we have shown from the Court's own expressions in *Quill,* rather than expanding upon the *Bellas Hess* minimum connection physical presence requirement, the *Quill* decision cannot be substantively construed as other than a somewhat begrudging retention of the *Bellas Hess* physical presence requirement-a "result", as the Court in its opinion remarked, "not dictate [d] * * * were the issue to arise for the first time today" (*Quill Corp. v. North Dakota,* 504 U.S., at 311, 112 S.Ct., at 1912, *supra*).

Even more importantly, acceptance of the thesis urged by Orvis and VIP-that *Quill* made the substantial nexus prong of the *Complete Auto* test an in-State substantial physical presence requirement-would destroy the bright-line rule the Supreme Court in *Quill* thought it was preserving in declining completely to overrule *Bellas Hess.* Inevitably, a *substantial* physical presence test would require a "case-by-case evaluation of the actual burdens imposed" (504 U.S., at 315, 112 S.Ct., at 1914) on the individual vendor involving a weighing of factors such as number of local visits, size of local sales offices, intensity of direct solicitations, etc., rather than the clear-cut line of demarcation the Supreme Court sought to keep intact by its decision in *Quill.* Thus, ironically, the interpretation of *Quill* urged by the vendors here would undermine the principal justification the Supreme Court advanced for its decision in that case, the need to provide certainty in application of the standard and with it, repose from controversy and litigation for taxing States and the nearly $200 billion-a-year mail-order industry, with respect to sales and use taxes on interstate transactions.

Finally, confirmation that the Supreme Court never intended to elevate the nexus requirement to a substantial *178 physical presence of the vendor can be found in *Oklahoma Tax Commn. v. Jefferson Lines,* 514 U.S. ----, 115 S.Ct. 1331, *supra,* the Supreme Court's most recent pronouncement in the interstate sales and use tax field. In that case, the Court did *not* apply a substantial physical presence test, but instead strictly utilized the substantial nexus prong of the *Complete Auto* test without even passing reference to the substantiality of the physical presence of the vendor (an interstate bus company) in the taxing State. Relying upon landmark cases decided before *Quill,* the Court focused on the in-State *activity* involved in the taxed transaction, such as the site of the origination or consummation of the transaction the State sought to tax (*see, id.,* 514 U.S., at ----, 115 S.Ct., at 1338 [citing *McGoldrick v. Berwind-White Co.,* 309 U.S. 33, 60 S.Ct. 388, *supra; Goldberg v. Sweet,* 488 U.S. 252, 109 S.Ct. 582, *supra*]). "Oklahoma is where the ticket is purchased, and the service originates there. These facts are enough for concluding that '[t]here is "nexus" aplenty here' " (*id.,* 514 U.S., at ----, 115 S.Ct., at 1338).

[1] We think the foregoing survey of the decisional law discloses the true import of the physical presence requirement within the substantial nexus prong of the *Complete Auto* test under contemporary Commerce Clause analysis. While a physical presence ***687 **961 of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a "slightest presence". (*see, National Geographic v. California Equalization Bd.,* 430 U.S. 551, 556, 97 S.Ct. 1386, 1390, *supra*). And it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf.

IV.

Applying the foregoing standard for a vendor's physical presence in the taxing State we think is required under *Quill Corp.* and *Bellas Hess,* we conclude that there was substantial evidence to support the State Tax Appeals Tribunal's determination that the activity of

Orvis and of VIP in this State were sufficient to impose the obligation to collect compensating use taxes on their taxable retail sales to New York customers. Neither Orvis nor VIP sustained its definite burden of establishing immunity under the Commerce Clause from that tax collection obligation (*see, General Motors v. Washington,* 377 U.S. 436, 441, 84 S.Ct. 1564, 1568, 12 L.Ed.2d 430; *Norton Co. v. Department of Revenue,* 340 U.S. 534, 537, 71 S.Ct. 377, 379, 95 L.Ed. 517), nor their general burden under our case law of proving ***179** sufficient facts to overcome an assessment and to demonstrate that the determination of the State Tax Appeals Tribunal was clearly erroneous (*Matter of Grace v. New York State Tax Commn.,* 37 N.Y.2d 193, 195-196, 371 N.Y.S.2d 715, 332 N.E.2d 886).

[2] In a March 1981 written response to an inquiry from a State Sales Tax auditor, Orvis' treasurer described its operations in New York as follows: "Some salesmen who reside in Vermont travel into New York to call on non-Orvis owned stores. The salesmen in no way bind the Orvis Company; all orders are approved in Vermont." A subsequent audit of Orvis' records disclosed that during the three years under audit, Orvis' annual sales to New York customers varied from $1 million to $1.5 million, about 15% of which consisted of wholesale purchases made by from 9 to 16 unaffiliated New York retail establishments. Contrary to the holding of the Appellate Division, the foregoing evidence supported a reasonable inference by the Tax Appeals Tribunal that Orvis' substantial wholesale business in this State was generally accomplished by means of its sales personnel's direct solicitation of retailers through visits to their stores in New York, subject only to approval of all orders in Vermont.[FN3] This sales activity in New York would presumptively suffice as a nexus to impose a use tax collection responsibility (*see, Felt & Tarrant Co. v. Gallagher,* 306 U.S. 62, 59 S.Ct. 376, *supra; see also, National Geographic v. California Equalization Bd.,* 430 U.S. 551, 97 S.Ct. 1386, *supra* [required vendor's presence need not directly relate to the taxed activity]).

> FN3. A form letter Orvis sent to retail establishments showed that Orvis extended credit to wholesale purchasers and that it imposed a "minimum stocking order of $3000" upon its wholesale customers. This evidence supports the conclusions (1) that the wholesale orders from sales solicitations in New York (admitted in Orvis' March 1981 letter) were indeed substantial, and (2) Orvis, in extending credit to New York wholesale purchasers, necessarily relied upon and utilized the banking and legal systems of this State.

[3][4] It was not unreasonable for the Tribunal to give little if any weight to the affidavits Orvis submitted of its president and treasurer averring that there were only 12 visits to New York retailers by Orvis personnel during the audit period and not for the purposes of sales promotion but only to discuss problems such as concerning shipping and to check on how Orvis products were displayed. It is true, as noted by the Appellate Division, that the Regulations of the State Department of Taxation and Finance authorize the submission of affidavits in ***180** lieu of oral testimony (*see,* 20 NYCRR 3000.10[d][1]). The existence of the regulation did not, however, prevent the Tribunal from rejecting the credibility of the affidavits submitted under the circumstances presented in this case. The fact is, on the crucial issue in this litigation, Orvis declined to expose its witnesses to cross-examination by producing them at the hearing before the State Tax Appeals Tribunal. As the Tribunal also noted in discrediting the affidavits, *****688 **962** their description of the purposes of Orvis contacts with retailers in this State was indeed inconsistent with the admissions against Orvis' interest contained in its initial response to the inquiry of New York taxing authorities. The Tribunal, in relying on the foregoing factors did not act arbitrarily or capriciously in concluding that the Orvis affidavits lacked credibility.

Moreover, the affidavits of Orvis' officers described the trips to New York of Orvis personnel as "in a loop", suggesting systematic visitation to all of its as many as 19 wholesale customers on the average of four times a year. This demonstrably exceeded the "slightest presence" of Orvis in New York (*National Geographic v. California Equalization Bd., supra*). Without even a credible let alone cogent explanation of why the March 1981 portrayal of Orvis' sales activity physically occurring in New York was inaccurate, the State Tax Appeals Tribunal was not arbitrary or capricious in concluding that Orvis failed to meet its burden of demonstrating its constitutional immunity. We have also considered Orvis' additional objections to the assessment and penalties imposed and find them equally unpersuasive. However, additional arguments raised by Orvis to the Appellate Division,

and not considered by that Court, need to be remitted to that Court for its disposition. Also before us is Orvis' cross appeal to this Court seeking recovery of attorney's fees. Inasmuch as Orvis has not succeeded on the merits of its constitutional challenge to the tax assessment, it has no entitlement to such fees.

[5] There likewise was substantial evidence to support the Tax Appeals Tribunal's determination upholding the sales and use tax assessment against VIP. Evidence was submitted from which the Tribunal could reasonably infer that VIP's hardware and software sales agreements obligated it to provide a charge-free visit of a VIP computer software installer at its beverage-distributor customer's site in New York if problems necessitating the visit occurred within the first 60 days of installation. Moreover, VIP's invoices showed charges for travel expenses to its New York customers' locations on 41 ***181** occasions, in order to resolve the more intractable problems involving its computer hardware and software, during the three-year audit period, in which VIP had 154 taxable transactions in New York. There was ample support in the record for the State Tax Appeals Tribunal's finding that VIP's trouble-shooting visits to New York vendees and its assurances to prospective customers that it would make such visits enhanced sales and significantly contributed to VIP's ability to establish and maintain a market for the computer hardware and software it sold in New York. VIP's activities in New York were, thus, definite and of greater significance than merely a slightest presence (*see, Standard Steel Co. v. Washington Revenue Dept.,* 419 U.S. 560, 562, 95 S.Ct. 706, 708, *supra* [in-State presence of a single employee of vendor "made possible the realization and continuance of valuable contractual relations between (the interstate vendor and its customer)"]). As with Orvis, we find VIP's additional objections to the assessment and penalties equally without merit.

Accordingly, the judgment in *Matter of Orvis Co. v. Tax Appeals Tribunal* should be modified in accordance with the opinion herein, and the matter remitted to the Appellate Division for consideration of issues raised but not reached at that Court. The judgment in *Matter of Vermont Information Processing v. Tax Appeals Tribunal* should be reversed, and the determination of respondent Tax Appeals Tribunal reinstated and confirmed and the petition dismissed, with costs.

BELLACOSA, Judge (dissenting).
Because we agree with the Appellate Division's grant of the respective petitions to annul the determinations of the Tax Appeals Tribunal, we respectfully dissent and vote to affirm in each case.

The Court is unanimous that the governing constitutional standard is "substantial nexus" of the taxpayer's business activities to the taxing State and not "substantial physical presence." Judge Ciparick and I conclude, however, that the minuscule, infrequent activities in New York by the two Vermont vendors do not satisfy the "substantial nexus" threshold requirement imposed by the Commerce Clause of the United States Constitution*****689 **963** (art. I, § 8, cl. [3]), and the governing interpretations promulgated by the United States Supreme Court.

It seems to us that the majority's articulation miscasts the evolution of United States Supreme Court Commerce Clause precedents and injects confusion when a "substantial nexus" ***182** bright line has been the guiding hallmark and jurisprudential goal. Functionally and commercially, telling out-of-State businesses that they dare not dip their toes within New York's borders without incurring New York taxes is not the teaching of the United States Supreme Court cases. Rather, deterring interstate traffic in such respects by taxation is precisely what is forbidden under the mantle of the Commerce Clause. Thus, absent evidence of a "small sales force, plant, or office" (*Quill Corp. v. North Dakota,* 504 U.S. 298, 315, 112 S.Ct. 1904, 1914, 119 L.Ed.2d 91), or "*continuous* local solicitation" (*Scripto v. Carson,* 362 U.S. 207, 211, 80 S.Ct. 619, 621, 4 L.Ed.2d 660 [emphasis added]), within New York State, imposition of the taxes at issue should be unconstitutional.

The question devolves to whether Orvis Company, Inc. and Vermont Information Processing, Inc., businesses not authorized and not doing business in New York, nevertheless by their minimal acts or course of business venturings arising out of sporadic commercial transactions in New York, entangled themselves in New York State's wide taxing web.

A State may not tax the economic activity of a foreign business engaged in interstate commerce unless "the tax is applied to an activity with a *substantial nexus* with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly

related to the services provided by the State" (*Complete Auto Tr. v. Brady,* 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326 [1977] [emphasis added]). The Supreme Court has repeatedly applied this principle in subsequent cases, most recently in *Oklahoma Tax Commn. v. Jefferson Lines,* 514 U.S. 175, ----, 115 S.Ct. 1331, 1338, 131 L.Ed.2d 261 [1995]. The present cases turn solely on the first prong, i.e., whether New York has a substantial nexus with the interstate activities of these two Vermont businesses to sustain a New York State sales and use tax.

A precise appreciation and reflection of the precedential building blocks is essential in this highly technical field. In *National Bellas Hess v. Department of Revenue,* 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 [1967], the State of Illinois sought to impose a use tax on National, a mail-order business with its principal place of business in Missouri. National did not own any real property, maintain an office, sales house or warehouse in Illinois, and it did not have any agents, salespeople or other type of continuous representation in Illinois. National's only link to Illinois was via the United States mail or a common carrier.

Under Illinois statute, National was required to collect and ***183** pay to the State a tax imposed upon Illinois consumers who purchase the company's goods for use in the State. National argued that the tax created an unconstitutional burden upon interstate commerce. The Supreme Court ruled in favor of the putative taxpayer. The Court declared that "if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation" (*id.,* at 759, 87 S.Ct., at 1392-1393). In 1992, the Supreme Court ruled in *Quill Corp. v. North Dakota,* 504 U.S. 298, 112 S.Ct. 1904, *supra* that *Bellas Hess* was still valid, operative and consistent with its decision in *Complete Auto Tr. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, *supra.*

Quill settled two important facets of the rules. First, the nexus requirements of the Due Process and Commerce Clauses are not the same. Thus, a foreign corporation may engage in "minimum contacts" to satisfy the Due Process Clause, but still lack "substantial nexus" to support a State's taxing reach under the Commerce Clause. Second, the imposition of the duty to collect sales and use taxes on a foreign corporation is subject to a physical presence or functional equivalent requirement. The Court stated:

"Like other bright-line tests, the *Bellas Hess* rule appears artificial at its edges: Whether or not a State may compel a *****690 **964** vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office. * * * This artificiality, however, is more than offset by the benefits of a clear rule. Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes. * * * [A] bright line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals" (*Quill, supra,* at 315-316, 112 S.Ct., at 1914-1915 [citations omitted]).

New York's approach, now approved by this Court in the instant two cases, contradicts that rationale, certainty and the bright-line approach. It allows businesses to be tax-nicked at the "edges." Notably, *Quill* excludes from interstate taxation commercial activities which are not based on the physical presence of a "small sales force, plant, or office" in the taxing State (*id.,* at 315, 112 S.Ct., at 1914). Accordingly, sporadic sojourns into a State will not supply an adequate nexus to overcome the Commerce ***184** Clause protection (*compare, Miller Bros. Co. v. Maryland,* 347 U.S. 340, 346-347, 74 S.Ct. 535, 539-540, 98 L.Ed. 744 [a Due Process Clause case]).

We disagree with the majority's suggestion that *Miller Bros. Co. v. Maryland (supra)* is essentially irrelevant (majority opn., at 175, n. 2, p. 685, n. 2 of 630 N.Y.S.2d, p. 960, n. 2 of 654 N.E.2d). *Miller* required the demonstration of "some definite link, some minimum connection, between a state and the person * * * or transaction it seeks to tax" (347 US, at 344-345, 74 S.Ct., at 538), and the Supreme Court ruled not to allow the imposition of the use tax on the Delaware merchandiser (*Miller Bros. Co. v. Maryland,* 347 U.S. 340, 340-345, 74 S.Ct. 535, 535-538, *supra*). The case rests on a different analysis of economic exploitation of consumer markets. Thus, it retains its vitality, relevance and analogous usefulness to the distinct analysis and disposition of the instant case.

The following cases are also important to scan the full landscape. In *National Geographic v. California Equalization Bd.,* 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 [1977], the Supreme Court held that the

State of California's imposition of a use tax liability on the Society's mail-order operation did not violate the Commerce Clause, since the Society had *two offices* in the State of California and "activities there adequately establish [ed] a relationship or 'nexus' between the [magazine] and the State" sufficient to support the tax (*id.*, at 556, 97 S.Ct., at 1390). Similarly, in *Standard Steel Co. v. Washington Revenue Dept.*, 419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719, the State of Washington's imposition of a tax levied on Standard's unapportioned gross receipts of sales made to Boeing Company, in Seattle, was not repugnant to the Commerce Clause, since one of Standard's employees maintained *an office* in the State of Washington (*see also, Tyler Pipe Indus. v. Department of Revenue,* 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199; *Holmes Co. v. McNamara,* 486 U.S. 24, 32, 108 S.Ct. 1619, 1624, 100 L.Ed.2d 21). Furthermore, in *Felt & Tarrant Co. v. Gallagher,* 306 U.S. 62, 64, 59 S.Ct. 376, 377, 83 L.Ed. 488, the State of California sought to impose a use tax against an Illinois corporation. The Court upheld the imposition of the tax where the Illinois corporation had hired two general agents to solicit sales orders in California and contracted to pay the rent of a California *office* maintained for each agent (*see also, Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197; *General Motors v. Washington,* 377 U.S. 436, 84 S.Ct. 1564, 12 L.Ed.2d 430; *accord, Nelson v. Sears, Roebuck & Co.,* 312 U.S. 359, 61 S.Ct. 586, 85 L.Ed. 888; *Nelson v. Montgomery Ward,* 312 U.S. 373, 61 S.Ct. 593, 85 L.Ed. 897 [no Commerce Clause violation where sellers maintained local retail stores in taxing State]).

Importantly, in the absence of an in-State plant or office, substantial nexus has been found to exist only when the ***185** foreign vendor maintains "*continuous local solicitation* " within the taxing State (*Scripto v. Carson,* 362 U.S. 207, 211, 80 S.Ct. 619, 621, *supra* [emphasis added]; *Miller Bros. Co. v. Maryland,* 347 U.S. 340, 346, 74 S.Ct. 535, 539, *supra; see, National Geographic v. California Equalization Bd.,* 430 U.S. 551, 557, *****691 **965** 97 S.Ct. 1386, 1390, *supra; National Bellas Hess v. Department of Revenue,* 386 U.S. 753, 757, 87 S.Ct. 1389, 1391, *supra*). In *Scripto,* a Georgia corporation sold certain mechanical writing instruments to Florida residents. Scripto did not own or lease any office or plant in Florida. However, the corporation had written contracts with 10 sales "brokers," who were residents of Florida. The detailed contracts described the brokers as representatives of "Scripto for the purpose of attracting, soliciting and obtaining Florida customers." Although the salespeople were independent contractors, they provided Scripto with "continuous local solicitations in Florida," which satisfied the substantial nexus requirement (*Scripto v. Carson,* 362 U.S. 207, 211, 80 S.Ct. 619, 621, *supra*).

The instant cases fall neither under *Scripto* nor *National Geographic.* The majority, we respectfully suggest, focuses too narrowly on the legal relationship between Scripto and its agents, rather than on the regularity and durational aspects of the agents' economic activities in the taxing State. The latter features are dispositive and key under the legal tests in *Quill* and *Scripto.* The Supreme Court expressly stated that the fact that "the 'sales[people' were] not regular employees of [Scripto] devoting full time to its service" had no constitutional significance, because "[t]he test is simply the *nature and extent of the activities* * * * in [the taxing State]" (*Scripto v. Carson, supra,* at 211-212, 80 S.Ct., at 621-622 [emphasis added]). Highly significant in these cases involving our application of exclusively governing Supreme Court jurisprudence is the fact that the Supreme Court itself has repeatedly stated that *Scripto v. Carson (supra)* "represents the furthest constitutional reach to date of a State's power to deputize an out-of-state retailer as its collection agent for a use tax" (*National Bellas Hess v. Department of Revenue,* 386 U.S. 753, 757, 87 S.Ct. 1389, 1392, *supra; see, Quill Corp. v. North Dakota,* 504 U.S. 298, 306, 112 S.Ct. 1904, 1909, *supra*). We believe that the instant cases go "further".

Relevantly, in *General Trading Co. v. State Tax Commn.,* 322 U.S. 335, 64 S.Ct. 1028, 88 L.Ed. 1309, a Minnesota corporation, which maintained no office or place of business in Iowa, solicited sales in Iowa by salespeople from headquarters in Minnesota where the goods were shipped by common carrier into Iowa. The United States Supreme Court made no mention in the decision of the number***186** of salespeople or the regularity of their excursions to solicit sales in Iowa. However, in referencing the facts of *General Trading* in a Due Process Clause case, *Miller Bros. Co. v. Maryland,* 347 U.S. 340, 346, 74 S.Ct. 535, 539, *supra,* the Supreme Court noted "[t]hat was the case of an out-of-state merchant entering the taxing state through traveling sales agents to conduct *continuous local solicitation* * * * the only nonlocal phase of the total sale being acceptance of the order" (emphasis

added). Indeed, it was the absence of continuous local solicitation which led the Supreme Court in *Miller Bros. (supra)* to hold that the State of Maryland could not impose the duty to collect a use tax on a Delaware merchandising corporation, although Miller made occasional deliveries into Maryland.

These precedents, taken together, in our respectfully tendered view, provide no constitutional hook to sustain the imposition of sales and use taxes assessed against these two Vermont vendors. The Tax Appeals Tribunal acknowledged that neither vendor maintained, leased or owned any office, distribution house or any other place of business in New York; nor do they own any tangible property, real or personal in New York; nor do they have a telephone listing in New York; nor do they have any agents or representatives stationed in New York. They, thus, have not provided New York with the key to the tax coffers box-a *substantial* nexus to New York by their activities here.

Orvis Company, Inc. submitted two affidavits to rebut the imposition of the use tax. The first affidavit, dated November 16, 1990, was signed by Leigh H. Perkins, president of the Orvis Company, Inc. Perkins stated that employees of Orvis' wholesale division visited New York retailers on a "sporadic, irregular basis." The purpose of the visits was to communicate with the retailers about problems in shipments, questions regarding display of the product, and to inspect the establishments***692 **966** of retailers selling Orvis products. Lastly, Perkins stated that "[t]he purpose of these visits was not to solicit sales to retailers nor to obtain purchase orders from the retailers."

The second affidavit, dated November 19, 1990, was signed by Thomas S. Vaccaro, a vice-president and the treasurer of the Orvis Company, Inc. Vaccaro's affidavit repeated many of the same facts set forth in Perkins' affidavit, but also attached a worksheet depicting the number of trips in New York State taken by Orvis Company, Inc. wholesale division employees during the assessment period, September 1, 1977 through August 31, 1980. During the 36-month assessment period, Orvis' employees *187 made 12 trips to New York. The State relies on a letter signed by Vaccaro, dated March 27, 1981. In that letter, Vaccaro stated that "[s]ome salesmen who reside in Vermont travel into New York to call on non-Orvis owned stores. The salesmen in no way bind the Orvis Company; all orders are approved in Vermont."

The letter and affidavits honestly acknowledge Orvis' de minimis, fleeting dashes into New York State. This is not the stuff of a cognizable, constitutional threshold called "*substantial* nexus," absent any of the other physical presence features of "continuous local solicitation" (*Scripto v. Carson,* 362 U.S. 207, 211, 80 S.Ct. 619, 621, *supra* [emphasis added]; *Miller Bros. Co. v. Maryland,* 347 U.S. 340, 346, 74 S.Ct. 535, 539, *supra*). Orvis' New York drop-ins look very much like Miller's occasional deliveries into Maryland (*see, id.*), and amounted to nothing more than a "*slight* [ ] presence" in New York (*National Geographic v. California Equalization Bd.,* 430 U.S. 551, 556, 97 S.Ct. 1386, 1390, *supra* [emphasis added]).

Likewise, Vermont Information Processing, Inc. had no employees in New York, did not employ salespeople to travel into New York to solicit sales, nor did it advertise in New York or engage in direct mail solicitation. Most of VIP's customers heard about VIP's products through word-of-mouth, and it was VIP's policy to invite interested parties to Vermont for demonstrations. If a customer decided to purchase VIP's services, VIP would send a contract by United Parcel Service. The final product, whether it was an entire computer hardware system or simply computer software, was shipped to the customer via common carrier. VIP's customers were usually trained to use the programs developed for them at VIP's headquarters in Vermont. VIP's personnel were available to customers by telephone to resolve problems. In addition, if software modifications were required, VIP installers were able directly to access a customer's computer from VIP's own computer system in Vermont through the use of a modem. In fact, during the entire assessment period, December 1, 1983 through November 30, 1986, VIP personnel made at most 41 visits to New York to service existing clients, never to solicit new customers. In our view, VIP's relatively occasional sojourns into New York State cannot represent anything more than a slight physical presence, and surely do not qualify as "continuous local solicitation." VIP, like Orvis, lacked continuouspresence *188 in New York, which is the *sine qua non* of the "substantial nexus" test.

These businesses evidently tried to conform their business practices to legitimately avoid incurring multistate taxation in accordance with the teaching of

Quill (*Quill Corp. v. North Dakota,* 504 U.S. 298, 309-317, 112 S.Ct. 1904, 1911-1915, *supra*). Despite their best efforts, they are now snagged by the ever-widening net that unsettles expectations, discourages investment and legitimate interstate commercial intercourse and tears at the mantle of Commerce Clause protection.

In sum, the "nature and extent of the activities" (*Scripto v. Carson,* 362 U.S. 207, 211, 80 S.Ct. 619, 621, *supra*) of these two Vermont vendors are less "substantial" than all previous cases where "substantial nexus" has been found to exist. If the minimal forays in these cases are sufficient for New York to tax these businesses, so, too, can every other State, municipality and political subdivision throughout the Nation for minimally qualifying conduct (*National Bellas Hess v. Department of Revenue,* 386 U.S. 753, 759, 87 S.Ct. 1389, 1392, *supra*). Finally and intuitively, these cases present an ***693 **967 interesting contradiction in the facts of their minimal conduct and the law of substantial nexus.

KAYE, C.J., and Judges SIMONS, TITONE and SMITH, JJ., concur with LEVINE, J.
BELLACOSA, J., dissents and votes to affirm in a separate opinion in which CIPARICK, J., concurs.
In *Matter of Orvis Co. v. Tax Appeals Tribunal:* Judgment modified, with costs to appellant-respondent Commissioner, and matter remitted to the Appellate Division, Third Department, for further proceedings in accordance with the opinion herein and, as so modified, affirmed.

In *Matter of Vermont Information Processing v. Tax Appeals Tribunal:* Judgment reversed, with costs, and petition dismissed.

N.Y.,1995.
Orvis Co., Inc. v. Tax Appeals Tribunal of State of N.Y.
86 N.Y.2d 165, 654 N.E.2d 954, 630 N.Y.S.2d 680, 64 USLW 2012

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Westlaw

4 P.3d 469
197 Ariz. 414, 4 P.3d 469, 326 Ariz. Adv. Rep. 19
(Cite as: 197 Ariz. 414, 4 P.3d 469)

Court of Appeals of Arizona,
Division 1, Department T.
ARIZONA DEPARTMENT OF REVENUE, an agency of the State of Arizona, Plaintiff-Appellant,
v.
CARE COMPUTER SYSTEMS, INC., a Washington corporation, Defendant-Appellee.
No. 1 CA-TX 98-0003.

July 25, 2000.

Arizona Department of Revenue (ADOR) appealed from a decision of the State Board of Tax Appeals, which vacated a retail transaction privilege tax imposed on an out-of-state taxpayer who sold and licensed computer hardware and software to nursing homes. The Arizona Tax Court, No. TX 95-00642, William J. Schafer, III, J., granted summary judgment to the taxpayer, and ADOR appealed. The Court of Appeals, Noyes, J., held that there was a sufficient nexus between the State and the taxpayer's business activities to subject the taxpayer to the State's retail transaction privilege tax.

Reversed and remanded with directions.

Fidel, P.J., filed dissenting opinion.

West Headnotes

[1] Licenses 238 ⚿5

238 Licenses
238I For Occupations and Privileges
238k2 Power to License or Tax
238k5 k. States. Most Cited Cases
Retail transaction privilege tax does not require a higher level of nexus with the taxing state than does a use tax.

[2] Licenses 238 ⚿5

238 Licenses
238I For Occupations and Privileges
238k2 Power to License or Tax
238k5 k. States. Most Cited Cases
There was a sufficient nexus between the State and an out-of-state taxpayer's business activities to subject the taxpayer to the State's retail transaction privilege tax; the taxpayer sold and licensed computer hardware and software to nursing homes, it had a market in the State, in which it engaged in about 180 transactions, it permanently assigned a salesperson to cover the State, it routinely sent training personnel into the State, trips by its salesperson to the State were intended to, and did, result in additional sales of its products, and while leases in the State were few in number and duration, they could, and did, develop into outright sales.

[3] Licenses 238 ⚿50

238 Licenses
238II In Respect of Real Property
238k50 k. Construction and Operation in General. Most Cited Cases
For purposes of determining whether an out-of-state taxpayer has a sufficient nexus with the State to support imposition of a retail transaction privilege tax, the volume of local activity is less significant than the nature of its function on the taxpayer's behalf.

[4] Administrative Law and Procedure 15A ⚿ 416.1

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(C) Rules and Regulations
15Ak416 Effect
15Ak416.1 k. In General. Most Cited Cases
Administrative agency must follow its own rules and regulations.

[5] Licenses 238 ⚿5

238 Licenses
238I For Occupations and Privileges
238k2 Power to License or Tax
238k5 k. States. Most Cited Cases
Administrative Code section providing that "[s]ales made by vendors maintaining a place of business within Arizona are subject to the Sales Tax" does not preclude imposition of retail transaction privilege tax on an out-of-state taxpayers who do not maintain a place of business within the State. Ariz. Comp. Admin. R. & Regs. R15-5-2307.

[6] Taxation 371 ⇐3603

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(A) In General
371k3601 Nature of Taxes
371k3603 k. Use Tax. Most Cited (Formerly 371k1202)
State's sales tax and use tax are complementary and intended to reach all applicable transactions, either by imposing a sales tax on the seller or a use tax on the purchaser; as the "maintaining a place of business" definition expands with constitutional interpretation, the reach of the sales tax necessarily expands, and the reach of the use tax necessarily contracts.
****469 *414** Janet Napolitano, Attorney General by Joseph Kanefield, Assistant Attorney General, Phoenix, for Appellant.

Lewis and Roca LLP by John P. Frank and Patrick Derdenger, Phoenix, for Appellee.

OPINION

NOYES, Judge.

¶ 1 The Arizona Department of Revenue ("ADOR") assessed a retail transaction privilege tax on Care Computer Systems, Inc. ("Care"). After the State Board of Tax Appeals vacated the assessment, ADOR appealed****470 *415** to the Tax Court, which granted summary judgment to Care on grounds that Care did not have "a substantial nexus with Arizona warranting a transaction privilege tax." ADOR then filed this appeal. Our jurisdiction is conferred by Arizona Revised Statutes Annotated section 12-2101(B) (1994), and our decision is guided by *Arizona Department of Revenue v. O'Connor, Cavanagh, Anderson, Killingsworth & Beshears, P.A.*, 192 Ariz. 200, 963 P.2d 279 (1997). We reverse and remand with directions to grant judgment to ADOR.

¶ 2 The material facts in this appeal from summary judgment are not in dispute. Our standard of review is accordingly *de novo* on questions of law and the application of legal principles to the undisputed facts. *See Brink Elec. Constr. Co. v. Arizona Dep't of Revenue,* 184 Ariz. 354, 358, 909 P.2d 421, 425 (1995).

¶ 3 The parties have acknowledged the relevance of *O'Connor* to their dispute. After ADOR filed its notice of appeal, the parties filed a joint motion to stay the appeal because, they reasoned, "the main issue in dispute in the [Care] case, i.e., the degree of nexus necessary for Arizona to constitutionally assess its Transaction Privilege Tax, is the exact same issue that is currently before the Arizona Supreme Court on the Department's Petition for Review in the *O'Connor* case." We granted the stay. After the supreme court denied review of *O'Connor,* we vacated the stay.

¶ 4 Both parties also acknowledge that *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), articulates the applicable test for state tax compliance with the "dormant" or "negative" Commerce Clause. After reviewing its earlier cases, the *Complete Auto* Court stated:

> These decisions ... have sustained a tax against Commerce Clause challenge when [1] the tax is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3]

> does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.

Id. at 279, 97 S.Ct. 1076. Both sides further agree that the main dispute here is whether Care's business activities had a "substantial nexus" with Arizona.

¶ 5 In *O'Connor,* as here, the question was whether Arizona activities of an out-of-state vendor created a sufficient nexus with Arizona to permit Arizona to impose retail transaction privilege taxes. 192 Ariz. at 201-02, 963 P.2d at 280-81. The out-of-state vendor, Dunbar Furniture, Inc., built custom workstations for an Arizona customer, the O'Connor law firm. Dunbar had no property, employees, offices, or showrooms in Arizona, although an Arizona retailer did serve as its independent representative on occasion. All negotiations between O'Connor and Dunbar took place in Arizona, either in person or by telephone. During that time, Dunbar employees brought two prototype workstations to Arizona and assembled them for review by O'Connor. Under the parties' contract, title to the workstations passed to O'Connor when they were delivered, and the risk of loss passed to O'Connor when they were installed. *See id.* at 202, 963 P.2d at 281. Dunbar employees delivered the workstations to Arizona. A local retailer installed them under contract with Dunbar and under supervision of a Dunbar factory representative. On three occasions thereafter, Dunbar sent employees to the O'Connor offices on warranty claims. *See id.* at 203, 963 P.2d at 282.

¶ 6 ADOR audited O'Connor and assessed use taxes on its workstation purchases. O'Connor protested the tax and prevailed at the administrative level on the theory that, because Dunbar's sales were subject to Arizona retail transaction privilege taxation, O'Connor was not liable for use taxation. The tax court ruled for ADOR. *See id.* We reversed the tax court. *See id.* at 208, 963 P.2d at 287. Relying on *Standard Pressed Steel Co. v. Department of Revenue of Washington,* 419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719 (1975); *Complete Auto,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326; *National Geographic Society v. California Board of Equalization,* 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977); ***416***Tyler Pipe Industries, Inc. v. Washington State Department of Revenue,* 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987); ****471** and *Quill Corp. v. North Dakota By and Through Heitkamp,* 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), we held that the activities performed in Arizona by and on behalf of Dunbar were significantly associated with Dunbar's ability to "establish and maintain" a market in Arizona for the sales. *O'Connor,* 192 Ariz. at 206, 963 P.2d at 285. The court's "establish and maintain" expression was taken from the following section of *Tyler Pipe:* "As the Washington Supreme Court determined, 'the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.' " 483 U.S. at 250, 107 S.Ct. 2810.

[1] ¶ 7 We begin our analysis in the present appeal by rejecting Care's argument that a retail transaction privilege tax requires a higher level of nexus with the taxing state than does a use tax. This argument is based on cases that were decided when state taxes on interstate commerce were *per se* unconstitutional. *See General Trading Co. v. State Tax Comm'n of Iowa,* 322 U.S. 335, 338, 64 S.Ct. 1028, 88 L.Ed. 1309 (1944); *McLeod v. J.E. Dilworth Co.,* 322 U.S. 327, 330, 64 S.Ct. 1023, 88 L.Ed. 1304 (1944). Later cases based on that same philosophy included *Freeman v. Hewit,* 329 U.S. 249, 67 S.Ct. 274, 91 L.Ed. 265 (1946), and *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573 (1951). Those two cases were expressly overruled in 1977 by *Complete Auto,* which upheld a privilege tax assessment on an interstate business's gross receipts from the taxing state. 430 U.S. at 288-89, 97 S.Ct. 1076.

> [T]he Court in *Complete Auto* did not merely overrule *Spector,* it also explicitly rejected the

> formalistic Commerce Clause doctrine that provided the foundation for the *Spector* rule. Thus, the court repudiated the "underlying philosophy ... that interstate commerce should enjoy a sort of 'free trade' immunity from state taxation." The Court likewise disapproved *Freeman v. Hewit*'s "blanket prohibition against any state taxation imposed directly on an interstate transac- tion."

1 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 4.11[1], at 4-46 (3d ed.1998).

[2] ¶ 8 We now decide whether a sufficient nexus existed between Care's business activities and Arizona to subject Care to Arizona's retail transaction privilege tax. In answering that question, we focus on whether the activities performed on Care's behalf in Arizona were "significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Tyler Pipe,* 483 U.S. at 250, 107 S.Ct. 2810.

¶ 9 Care is a Washington corporation that sells and licenses computer hardware and software to nursing homes throughout the United States. Care does not own or lease any real property in Arizona, it does not maintain any inventory in Arizona, it does not maintain a business address in Arizona, and it does not have any employees, independent contractors, or agents based or residing in Arizona.

¶ 10 During the audit period, Care engaged in approximately 180 transactions with Arizona nursing homes. Because Care dealt primarily with nursing home chains, most of its business resulted from mail orders initiated by other nursing homes in the chains. The vast majority of Care's Arizona transactions were conducted by mail or telefax. Two of the transactions were leases and the rest were sales. One lease was for a general ledger program; the other was for three programs and a computer. At the end of both lease terms, the lessees bought the leased goods, and Care credited seventy-five percent of the lease payments to the sales prices. The two transactions, including credited lease payments, totaled $21,720.39. The non-credited rental payments totaled $2,488.47.

¶ 11 Care had one salesperson assigned to Arizona. He lived in Irvine, California, throughout the audit period. His sales efforts focused almost exclusively on southern California. Although Arizona was part of his territory, the salesperson did not initiate sales relationships in Arizona. On seven occasions in the seven-year audit period, however, the Care salesperson took one- to two-**472 day *417 trips to Arizona to follow up on business prospects. Some sales and licenses resulted from these trips.

¶ 12 Care required that all customer contracts be approved by a corporate officer in Washington before the goods were shipped. All goods were shipped from Care's home office in Washington, F.O.B. origin, either by common carrier or U.S. mail. Title to hardware, software, forms, and supplies sold by Care thus passed to the customer in Washington on delivery to the common carrier or the U.S. Postal Service. By definition, however, title to products that Care leased or licensed to its customers did not pass to the customers. Approximately $105,000 of Care's income from Arizona transactions during the audit period consisted of software licensing fees.

¶ 13 Regarding the training provided by Care to its Arizona customers, Care Executive Vice President Jerry Nelson averred:

> Personnel from this company go to the nursing home site, in almost every case, only once. This is to conduct the initial training which may last from one to several days, depending on the number of programs involved. The training representative is dispatched from our home office or another service office, and returns immediately upon completion of the training.... The cost of the training is insignificant compared to the cost of the hardware and software; e.g., the list price of a computer system consisting of the hardware and basic accounting software would run approximately $20,000, whereas the training for such a

> purchase would cost approximately $1,400. Not all sales involve training at the customer site.... [S]ales to a chain of homes may entail training only once at a central site for a number of homes; or a nursing home may simply opt to do its own training with the help of the user documentation. A review of the business records of our company indicates that we had a training representative in Arizona at widely separated junctures 80 days out of the total 1370 days covered by the audit, July 1, 1987 through March 31, 1991. This amounts to approximately 21 [sic] days per year.
>
> Essentially, all the subsequent support for the computer system is rendered on an interstate basis involving the mail or telephone.... It is extremely rare for our personnel to go back on site after the initial training, largely because the telephone support suffices.

[3] ¶ 14 Although Care's Arizona activity was of relatively low volume, "the volume of local activity is less significant than the nature of its function on the out-of-state taxpayer's behalf." *O'Connor,* 192 Ariz. at 208, 963 P.2d at 287. In our opinion, the volume and function of Care's Arizona activity equal or exceed that seen in *O'Connor.* Dunbar, the out-of-state vendor in *O'Connor,* had an Arizona market of one customer, with which it engaged in seventeen transactions. Care had an Arizona market of one *industry,* with which it engaged in about 180 transactions. Dunbar maintained no post-sale ownership of property in Arizona; Care did so with licenses and leases. Care permanently assigned a salesperson to cover Arizona; Dunbar did not. Care routinely sent training personnel into Arizona; Dunbar did not, although it did send in employees to do warranty work.

¶ 15 The trips by Care's salesperson to Arizona were intended to, and did, result in additional sales of Care products. The trips by Care trainers to Arizona were in part intended to, and presumably did, increase the satisfaction level of Arizona customers and encourage other members of that nursing home chain to buy Care products. The Care leases in Arizona were few in number and duration, but they could, and did, develop into outright sales. We therefore conclude that the function and effect of the Arizona activities by Care and Dunbar were the same, that the factual differences between the two cases are therefore not material, and that the result of the "substantial nexus" analysis should be the same in each case.

¶ 16 In addition to *O'Connor,* ADOR relies on *Brown's Furniture, Inc. v. Wagner,* 171 Ill.2d 410, 216 Ill.Dec. 537, 665 N.E.2d 795, 798, 803 (1996) (holding that vendor with no office, plant, or sales force in Illinois but who advertised there and made 942 deliveries there in ten months had substantial nexus with Illinois); ***418***Magnetek Controls, Inc. v. Revenue Division, Department of Treasury,* 221 Mich.App. 400, 562 N.W.2d 219, 224 (1997)****473** (finding substantial nexus from managers' regular travel to other states to assist independent sales representatives and attend trade shows); and *Orvis Co. v. Tax Appeals Tribunal of State of New York,* 86 N.Y.2d 165, 630 N.Y.S.2d 680, 654 N.E.2d 954, 961 (1995) (holding that visits by company personnel to New York for sales and customer relations created substantial nexus). Care asserts that those cases concerned use or sales taxes that vendors had to collect from customers, not transaction privilege or other excise taxes for which the vendors were themselves liable. The assertion is correct, but those cases are nevertheless relevant because they applied the *Complete Auto* test and focused on whether the taxpayers' activities established a "substantial nexus" with the taxing states.

¶ 17 Care relies on *State Tax Commission v. Murray Co. of Texas,* 87 Ariz. 268, 350 P.2d 674, *vacated,* 364 U.S. 289, 81 S.Ct. 53, 5 L.Ed.2d 39, *op. on remand,* 89 Ariz. 61, 358 P.2d 167 (1960),[FN1] a case that is mainly of historical interest because it was decided when taxation of interstate commerce was still precluded. Care also relies on *City of Phoenix v. West Publishing Co.,* 148 Ariz. 31, 712 P.2d 944 (1985). That case relied on *Murray,* preceded *Tyler Pipe,* drew no distinction between the

Due Process and Commerce Clause nexus requirements, and did not address the "crucial factor" articulated by *Tyler Pipe,* namely, whether West's business activities in Phoenix were significantly associated with establishing and maintaining a market in Phoenix for its sales. Had *West Publishing* focused on that crucial factor, the case might have been decided differently. We therefore distinguish *Murray* and *West Publishing.* Although a comparison of the facts here to the facts there does support Care, that support evaporates when one acknowledges the intervening evolution in Commerce Clause law.

> FN1. Overruling recognized in *Department of Revenue v. Moki Mac River Expeditions, Inc.,* 160 Ariz. 369, 373-74, 773 P.2d 474, 478-79 (1989), *disapproved in part on other grounds, Wilderness World, Inc. v. Department of Revenue,* 182 Ariz. 196, 200, 895 P.2d 108, 112 (1995).

[4][5] ¶ 18 Care also argues that an administrative agency must follow its own rules and regulations. We agree with that general proposition. *See, e.g., Cochise County v. Arizona Health Care Cost Containment Sys.,* 170 Ariz. 443, 445, 825 P.2d 968, 970 (1991). Care correctly notes that Arizona Administrative Code ("A.A.C.") R15-5-2307 [FN2] provides that "[s]ales made by vendors maintaining a place of business within Arizona are subject to the Sales Tax." Because Care does not maintain a place of business within Arizona, it argues that ADOR cannot impose a transaction privilege tax on it. We do not agree with that argument. Because "Arizona's use tax thus functions primarily as a complement to the retail transaction privilege tax," *O'Connor,* 192 Ariz. at 204, 963 P.2d at 283, Care's argument, if true, means that ADOR *could* have imposed a use tax on ****474 *419** Care's Arizona customers pursuant to A.A.C. R15-5-2308, which provides that "[p]urchases made from vendors not maintaining a place of business in this state to Arizona customers are subject to the Use Tax." That argument, however, was rejected by *O'Connor.*

FN2. In context, A.A.C. R15-5-2307 provides as follows:

R15-5-2306. Distinction Between Sales Tax and Use Tax

A. The Sales Tax is imposed on sales made by vendors located within Arizona, while the Use Tax is levied on purchases from out-of-state vendors.

B. Since the Sales Tax and Use Tax are complementary taxes, only one of the taxes can be applied to a given transaction.

R15-5-2307. When a Transaction is Subject to the Sales Tax

Sales made by vendors maintaining a place of business within Arizona are subject to the Sales Tax. Sellers operating from a commercial location or point of distribution, soliciting from a public place of business, or buying and selling articles on their own account within the state are deemed to be in business in Arizona.

For example, an office equipment dealer maintains a sales office in Arizona, solicits business from customers in Arizona, and orders the equipment from its home office out of state. Although the seller maintains no stock of inventory in Arizona and the products are shipped directly to the purchaser, he is nevertheless considered to be engaging in business within the state for purposes of this regulation. Such sales are taxable under the Sales Tax statutes.

R15-5-2308. When a Transaction is Subject to the Use Tax

Purchases made from vendors not maintaining a place of business in this state to

> Arizona customers are subject to the Use Tax. For example, purchases from an out-of-state vendor selling by mail order to Arizona residents are subject to the Use Tax.

¶ 19 In *O'Connor,* where ADOR imposed a use tax on the Arizona customer because the vendor did not maintain a place of business in Arizona, this court applied the *Complete Auto* test and the *Tyler Pipe* "crucial factor" and held that ADOR could not impose a use tax on the customer-because it could have imposed a retail transaction privilege tax on the vendor. *O'Connor,* 192 Ariz. at 204-08, 963 P.2d at 283-87. That holding illustrates that the vendor's place of business is an overly simplistic test in light of current Commerce Clause jurisprudence regarding taxation. That the regulation in question specifies that vendors maintaining a place of business in Arizona are subject to the sales tax does not necessarily mean that other vendors are not subject to the sales tax.

¶ 20 In *Brink Electric,* this court rejected an argument similar to the one that Care makes here. 184 Ariz. at 360, 909 P.2d at 427. In that case, the taxpayer argued that A.A.C. R15-5-608, which stated that "[i]nstallation of equipment which becomes permanently attached in a plant or other structure is taxable as a contracting activity," stood for the proposition that there could be no "contracting" with respect to equipment that did not become permanently attached. This court disagreed and held that "[t]he regulation certainly includes permanent attachment of equipment to a structure within the scope of contracting, but does not purport to exclude other real property improvements." *Id.* at 360 n. 6, 909 P.2d at 427 n. 6.

¶ 21 Similarly, while A.A.C. R15-5-2307 certainly says that a taxpayer who maintains a place of business in Arizona will be subject to the transaction privilege tax, it does not purport to exclude a taxpayer who does not maintain a place of business from the tax. In fact, several cases (including *Brink Electric*) have found a taxpayer that did not maintain a place of business in Arizona subject to the transaction privilege tax. *Arizona State Tax Commission v. Ensign,* 75 Ariz. 220, 227, 254 P.2d 1029, 1033 (1953), for example, held that an out-of-state taxpayer that did not maintain a place of business in Arizona, but that sold and installed deep well turbine pumps in the state, was subject to the transaction privilege tax on in-state sales because the elements of the sales were effected in Arizona. *See also Centric-Jones Co. v. Town of Marana,* 188 Ariz. 464, 478, 937 P.2d 654, 668 (1996) (upholding a transaction privilege tax on an out-of-state contractor for construction work performed on a portion of the Central Arizona Project located within the Town of Marana even though the contractor's offices were located in Denver, Colorado); *Moki Mac,* 160 Ariz. at 373-75, 773 P.2d at 478-80 (holding that a Utah river rafting business that did not maintain a place of business in Arizona nevertheless had enough activities in Arizona to establish a sufficient constitutional nexus to justify imposing the transaction privilege tax on its gross receipts); *Arizona Dep't of Revenue v. Hane Constr. Co.,* 115 Ariz. 243, 245-46, 564 P.2d 932, 934-35 (1977) (holding that an out-of-state contractor that did not maintain a place of business in Arizona but performed work on an Indian reservation had sufficient business activity in Arizona to be subject to the transaction privilege tax on its contracting income), *rev'd on other grounds, State of Arizona, ex rel., Arizona Dep't of Revenue v. Blaze Constr. Co.,* 190 Ariz. 262, 272, 947 P.2d 836, 846 (1997), *rev'd,* 526 U.S. 32, 39, 119 S.Ct. 957, 143 L.Ed.2d 27 (1999).

[6] ¶ 22 Arizona's sales tax and use tax are complementary; they are intended to reach all applicable transactions, either by imposing a sales tax on the seller or a use tax on the purchaser. As the "maintaining a place of business" definition expands with constitutional interpretation, the reach of the sales tax necessarily expands, and the reach of the use tax necessarily contracts, as evidenced by the holding and result in *O'Connor.* On facts not materially different from those in the present case,

O'Connor held that the use tax would not apply because the sales tax would apply. We follow that analysis here, and we reach the same result. Because the State cannot impose the use tax on **475 *420 Care's customers on the present facts and in light of the constitutional principles stated in *O'Connor,* the State can lawfully impose a sales tax on Care.

¶ 23 Reversed and remanded with directions to enter judgment for ADOR.

CONCURRING: THOMAS C. KLEINSCHMIDT, Judge.
FIDEL, Presiding Judge, dissenting.
¶ 24 My colleagues acknowledge the proposition that a regulatory agency must follow its own rules and regulations. *Ante* ¶ 18. That proposition, if applied, not merely acknowledged, would bring a swift and simple end to this unnecessarily complicated case.

¶ 25 The majority quotes the applicable regulations in footnote 2 to its opinion. The regulations are remarkably clear, not only when compared with other tax regulations but when compared with other regulations of any sort. R15-5-2306 informs the public that sales taxes (which, the court and parties agree, include transaction privilege taxes) and use taxes are meant to be complementary and that the former are imposed on sales by in-state vendors, while the latter are levied on purchases from out-of-state vendors. In keeping with this complementary intent, R15-5-2307 provides that "[s]ales made by vendors maintaining a place of business within Arizona are subject to the Sales Tax," and R15-5-2308 provides that "[p]urchases made from vendors not maintaining a place of business in this state [by] Arizona customers are subject to the Use Tax." These regulations were drafted in harmony, and there is nothing ambiguous about them. Because Care Computer Systems does not maintain a place of business within Arizona, ADOR, had it followed its own regulations, would have subjected Care's transactions with Arizona customers to a use tax, not a sales tax.

¶ 26 But, says the majority, "the vendor's place of business is an overly simplistic test in light of current Commerce Clause jurisprudence regarding [sales] taxation." *Ante* ¶ 19. In other words, ADOR is not constitutionally obliged to confine its sales taxing authority to vendors who maintain a place of business within Arizona; rather, it has constitutional leeway under current jurisprudence to impose sales taxes upon vendors who do not maintain a place of business within Arizona. Accordingly, the majority reasons, whatever regulations needlessly confine sales taxing authority so narrowly may be ignored.

¶ 27 By taking this approach, my colleagues achieve a curious result. They effectively invalidate R15-5-2306, -2307, and -2308 for taxing too narrowly-for failing to tax sales to the full extent that the Commerce Clause permits. This is curious because it reverses ordinary constitutional analysis. Ordinarily when courts find a statute or regulation incompatible with the Constitution, they find that it *exceeds* constitutional constraints. Here the opposite pertains; my colleagues render ADOR's sales tax regulations inoperative because they bite off less than ADOR is constitutionally permitted to chew.

¶ 28 I disagree with this approach. That ADOR might have adopted more comprehensive sales tax regulations is beside the point. The immediate question is not whether ADOR might constitutionally adopt broader regulations but whether ADOR must follow the narrower regulations that it has adopted and has not seen fit to change.

¶ 29 There are good reasons why Arizona law requires administrative agencies to follow their own rules and regulations. Our Administrative Procedure Act ("APA") not only requires the publication of existing agency rules and regulations, *see* A.R.S. §§ 41-1011, -1012, but also the publication of a monthly register concerning "proposed repeals, makings or amendments of rules." A.R.S. § 41-1013 (1999). The APA provides for public notice and comment before the adoption or amendment of agency rules. *See* A.R.S. §§ 41-1021

through -1036 (1999). The APA also requires the filing of an "economic, small business and consumer impact statement," A.R.S. §§ 41-1055 (1999) and 41-1056(A)(6) (Supp.1999) and screening by a governor's regulatory review council before a proposed regulation takes effect. *See* A.R.S. § 41-1051 (Supp.1999); A.R.S. §§ 41-1052 through -1053 (1999). Explaining this process, this court stated, "APA rulemaking requires**476 *421 public notice, and the opportunity for public participation and comment, to ensure that those affected by a rule have adequate notice of the agency's proposed procedures and the opportunity for input into the consideration of those procedures." *Carondelet Health Svcs., Inc. v. Arizona Health Care Cost Containment System Admin.,* 182 Ariz. 221, 226, 895 P.2d 133, 138 (1994).

¶ 30 Through publication of current rules and notice of amendments, an agency not only permits members of the public to comment on impending changes, but also to consult the evolving body of rules and regulations, determine the agency's approach to circumstances that its rules and regulations define, and order their affairs accordingly. And the purpose of permitting the public to order its affairs in accordance with published regulations is particularly keen for tax regulations that govern commercial transactions. When the parties to commercial transactions factor likely taxes into pricing decisions, they should do so in the confidence that the taxing authority will tax as its published regulations say it will tax, and not as it might tax under a different, unproposed, unapproved, and unadopted regulatory scheme.

¶ 31 In consequence, I see no need to embark on the quest for elusive nexus to resolve this case. On the far simpler ground that ADOR has failed to follow its own regulations, I would affirm. Because my colleagues have opened the subject of nexus, however, I will make one further point.

¶ 32 Whatever the substantive validity of Commerce Clause case jurisprudence before *Complete Auto,* the law then had the virtue of clarity. The earlier case law imposed a "blanket prohibition against any state taxation imposed directly on an interstate transaction." *Ante* ¶ 7. In *Complete Auto,* however, the Court made "substantial nexus" the touchstone of taxation of interstate transactions. And in *Tyler Pipe,* the Court defined "sufficient nexus" to include those activities "significantly associated with the taxpayer's ability to establish and maintain a market in [the taxing] state for the sales." *Ante* ¶ 8 (quoting *Tyler Pipe,* 483 U.S. at 250, 107 S.Ct. 2810).

¶ 33 I do not hold the majority responsible for the *Tyler Pipe* standard. They are stuck with it as are we all. To apply that standard to these facts and those of *O'Connor,* however, shows it to add bulk without nourishment to the law. What, other than ad hoc pronouncement, distinguishes an activity significantly associated with the taxpayer's ability to establish and maintain a sales market from an activity not significantly associated with that ability? One is hard pressed to say. The best the court can do is conclude by comparative analysis that, if the attenuated circumstances of *O'Connor* meet that standard, so must the equally attenuated circumstances of this case. And so, validating the taxation of one attenuated transaction after another after another, the courts erode the general standard of substantial nexus into something very insubstantial indeed.

¶ 34 "Substantial nexus" is a swamp we should stay out of in this case. If ADOR amends its regulations to detach sales taxes from the terra firma of the vendor's place of business, there will be time enough to gauge nexus. Until then, we should hold ADOR to regulations on the books.

¶ 35 For the foregoing reasons, I respectfully dissent.

Ariz.App. Div. 1,2000.
Arizona Dept. of Revenue v. Care Computer Systems, Inc.
197 Ariz. 414, 4 P.3d 469, 326 Ariz. Adv. Rep. 19

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2001 WL 718027 (Wash.Bd.Tax.App.)

Board of Tax Appeals
State of Washington

***1 CARR LANE**
MANUFACTURING CO., APPELLANT
v.
DEPARTMENT OF REVENUE, RESPONDENT

Docket No. 54917

January 22, 2001 .

RE: Excise Tax Appeal

PROPOSED DECISION

This matter came (Board) for an informal hearing on February 15, 2000. Eric Winschel, CPA, and Brian Humes, CPA, appeared for Appellant, **Carr Lane** Mfg. Co., Inc. (Taxpayer). Rex Munger, Tax Policy Specialist III, appeared for Respondent, Department of Revenue (Department).

This Board heard the testimony, reviewed the evidence, and considered the arguments made on behalf of both parties. This Board now makes its decision as follows:

ISSUES

The issues in this informal excise tax appeal are: (1) whether the Taxpayer has insufficient nexus with Washington to sustain the imposition of the B&O tax, and (2) whether Taxpayer's sales should be excluded from the measure of the B&O tax because they are delivered to Washington customers outside the State. We answer both questions in the negative, and sustain the Department's determination.

FACTS

The Taxpayer is a Missouri corporation engaged in manufacturing of tooling component parts. These parts are mostly small sized, consisting of valves and bushings shipped in bulk. These manufactured parts are sold throughout the country primarily by and through The Taxpayer's parts catalog. Taxpayer has sales representatives, inventories and district management in some states. Taxpayer does not have any employees, property or inventory in Washington. Parts are shipped by the Taxpayer from its out-of-state manufacturing plants. The terms are FOB shipping point, with title passing to the buyer at the time of shipment. The buyer bears the risk of loss and is responsible for the cost of shipment.

The Taxpayer provides its catalog of tooling component products to an unrelated distribution company in Washington. This distribution company is a parts wholesaler/distributor which re-sells a wide variety of products to

its customers from a network of over 150 suppliers for application in industry.

The Taxpayer has an employee in California who goes to Washington two or three times a year to deliver product catalog inserts to the parts wholesaler/distributor and explain new parts features and applications.

The Department audited the Taxpayer's books and records for the period January 1, 1992, through December 31, 1996. The Department determined that the Taxpayer had sufficient nexus to support the imposition of the B&O tax with respect to its sales to the Washington distributor. The Department further determined that the delivery of goods to the Washington distributor took place in Washington because the purchaser's shipping agent, United Parcel Service, did not have the authority and duty to inspect the goods for acceptance on behalf of the pur- chaser.

ANALYSIS AND CONCLUSIONS

Issue No. 1. Does the presence of Taxpayer's sales representative in Washington two or three time per year for the purpose of delivering updates to the Taxpayer's sales catalog and explaining new parts features and applications constitute sufficient nexus to support the imposition of the B&O tax?

*2 In order to pass muster under the Commerce Clause of the U.S. Constitution, Washington's B&O tax must meet the following tests: (1) there must be a sufficient nexus or connection between Washington and the activities taxed; (2) the tax must be fairly apportioned; (3) the tax cannot discriminate against interstate commerce in favor of local commerce; and (4) the tax must be fairly related to the services provided by Washington. Wash. St. Dept. of Revenue v. Assn. Of Washington Stevedoring Co's, 435 U.S. 734 (1978), citing Complete Auto Transit v. Brady, 430 U.S. 274 (1977). The term "sufficient nexus" means substantial nexus. Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

The Taxpayer's challenge to the Department's assessment implicates the first of these tests: substantial nexus. The Department's operative definition of "substantial nexus" for purposes of satisfying the Commerce Clause has three elements: (1) some sort of in-state activity; (2) an in-state physical presence related to that activity; and (3) the activity's purpose is to establish or maintain a position in Washington's marketplace. See Det. 96-147, 16 WTD 117 (1996). This Board recently concluded that regular, purposeful in-state sales solicitation activity by a company's employees or agents constitutes "substantial nexus" for B&O tax purposes as a matter of law when that activity is specifically directed at in-state customers. See Dynamic Information Systems Corp. v. Dept. of Revenue, BTA Docket No. 98-84 (2000).

The Department argues that the Taxpayer's in-state sales solicitation activities constitute "substantial nexus." We agree. The Taxpayer's employee made regular sales calls on its only Washington customer. As the Taxpayer itself explains: "...the 2 or 3 days a year spent at the Distribution Company is informational as to new products of taxpayer and to provide inserts for the catalog." Taxpayer Letter of April 27, 1999, p. 3. The purpose of the sales calls was clearly to maintain the Taxpayer's presence in Washington's market. The Department did not err when it concluded that the Taxpayer's Washington activities established sufficient nexus to overcome a challenge based on the Commerce Clause.

Issue No. 2. Should the Taxpayer's sales be excluded from the B&O tax because they are delivered to Washington customers outside the State.

The B&O tax on wholesaling activities reaches only wholesale sales which occur in Washington. WAC

458-20-193(7) states in relevant part:

> Washington does not assert B&O tax on sales of goods which originate outside this state unless the goods are received by the purchaser in this state and the seller has nexus. There must be both the receipt of the goods in Washington by the purchaser and the seller must have nexus for the B&O tax to apply to a particular sale. The B&O tax will not apply if one of these elements is missing.
>
> (a) Delivery of the goods to a freight consolidator, freight forwarder or for-hire carrier located outside this state merely utilized to arrange for and/or transport the goods into this state is not receipt of the goods by the purchaser or its agent unless the consolidator, forwarder or for-hire carrier has express written authority to accept or reject the goods for the purchaser with the right of inspection.

*3 The Taxpayer argues that it meets the terms of this WAC rule because its shipper, UPS, is the purchaser's agent and receives the goods on behalf of the Taxpayer's Washington customer at the Taxpayer's out-of-state manufacturing sites. The Taxpayer points to UPS's published tariff, wherein UPS retains the right to open and inspect any package tendered to it for transportation. In addition, the Taxpayer submitted a letter dated September 29, 1998, from its Washington customer to UPS, purporting to set forth its customer's understanding of the terms of UPS's carriage contract. The letter states, in its entirety:

> This letter is to reaffirm our prior understanding and terms pursuant to the receipt and delivery of products from **Carr-Lane** Mfg. Co., St. Louis, Missouri, to our company facilities in the .
>
> Receipt of products ordered is at the manufacturer's location, FOB, St. Louis, freight prepaid. Transfer of title to E. F. Bailey Co. occurs in St. Louis and we accept the risk of loss upon acceptance of the goods at St. Louis. United Parcel Service, as a for-hire freight carrier, has our express authority to accept or reject the goods on our behalf, including the right to inspect, count, or otherwise verify the goods being accepted for transport.
>
> The points mentioned above, along with the purchase order, bill of lading and any other sales documents combined to reflect the terms and conditions of the delivery and receipt of the purchased goods.

The Department reviewed the above documentation and concluded that it was insufficient to meet the out-of-state receipt requirements of WAC 458-20-193(7)(a), above. The Department's position, set out in Excise Tax Advisory 561.04.193, is as follows:

> For receipt to occur at the out-of-state location, the for-hire carrier must take those actions that would generally be taken by a prudent buyer to assure that the goods conform to the purchase order or contract. This generally requires at a minimum that the goods be physically examined by the receiving agent. The agent must also have access to the purchase order or contract in order to determine if the goods conform. The mere giving to the for-hire carrier of a written authority to accept the goods at an out-of-state location, without some further act of acceptance, will not be considered as receipt by the purchaser or the purchaser's agent at that location. In short, the carrier must not only have written authority to accept or reject goods for the buyer, it must actually do so and provide documentation of that fact to the seller.
>
> If the goods are given by the seller to a for-hire carrier in sealed containers and the containers are not opened by the purchaser until arrival in Washington, it will be presumed that receipt did not occur until the goods arrived in Washington, irrespective of any express written authority granted to the carrier. An agent acting for a buyer for receipt of goods must in some manner substantiate that the goods conform to the buyer's specifications.
>
> *4 The department will not accept a mere stamped or other "form-over-substance" shipping document as satisfying the requirement that the goods have been accepted by the buyer's agent outside the state. This ETB expresses the intent of Rule 193 from its inception.

We find this ETA to be fair and reasonable, and in further-ance of the Department's authority to administer the B&O tax in a manner consistent with the Commerce Clause. The Taxpayer has not shown otherwise.

The Department argues that the September, 1998 letter to UPS, quoted above, was dated after the Department's audit was completed and after the Department issued its first written determination to the Taxpayer, and therefore could not have constituted "express written authority to accept or reject the goods for the purchaser with the right of inspection," as that phrase is used in WAC 458-20-193(7)(a), above. We agree. In addition, we note that there is no evidence that UPS has agreed to the purchaser's understanding of its carriage contract, nor is there even a complete UPS shipping contract in evidence. We would be very surprised if the standard UPS contract did not contain a clause that limited the terms of its agreement to the express undertakings set forth in the standard written agreement.

In short, there is simply no evidence that UPS acted in any way as the purchaser's agent for "acceptance of the goods", i.e., determining whether the goods conformed to the buy/sell contract, at the FOB point. There is no evidence that UPS even knew of the terms of the buy/sell contract, or ever opened the shipping containers to attempt to determine if the goods conformed to it.

The Taxpayer attempts to avoid this evidentiary shortcoming by arguing:

> ...the nature of the goods Taxpayer sells to Distribution Company is small parts, valves and bushings by the hundreds (if not thousands). We suggest that in the practical business environment of accurate and timely delivery that a prudent buyer of parts, the volume of which we are dealing with in this case, would not insist upon inspecting each unit. Instead, they would rely on shipping and purchase order documentation reviewed at the dock by its agent.

The Taxpayer's suggestion as to what a prudent buyer might or might not do is not persuasive. The Taxpayer is a seller, not a buyer, and therefore its opinion as to a buyer's prudence is not entitled to weight. In addition, its opinion as to the buyer's prudence is counter-intuitive: reviewing shipping and purchase order documentation at the seller's dock confirms nothing in regard to whether the goods conform to the buy/sell contract, other than that the seller claims to have shipped what the buyer ordered. In any event, there is no evidence UPS had knowledge of the purchase order documentation, and thus could not have been the purchaser's agent for acceptance.

In sum, the Taxpayer has not established that the goods were "delivered" to the Taxpayer's customer outside Washington. Indeed, what evidence there is points to delivery in Washington, and we so conclude.

DECISION

*5 The determination of the Department of Revenue is affirmed.

DATED this 22nd day of January, 2001.

Matthew J. Coyle
Chair

2001 WL 718027 (Wash.Bd.Tax.App.)
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2000 WL 33267349 (Wash.Bd.Tax.App.)

Board of Tax Appeals
State of Washington

***1 DYNAMIC INFORMATION SYSTEMS**
CORPORATION, APPELLANT
v.
STATE OF WASHINGTON DEPARTMENT OF REVENUE, RESPONDENT

Docket No. 98-84

December 28, 2000

RE: Excise Tax Appeal

FINAL DECISION

This matter came (Board) for a formal hearing on November 30, 1999. Michael Martin, Attorney at Law, and Kevin O'Brien, Corporate Counsel appearing pro hac vice, appeared for Appellant, **Dynamic Information Systems** Corporation (Taxpayer). Cindy Evans, Assistant Attorney General, appeared for Respondent, Department of Revenue (Department).

This Board heard the testimony, reviewed the evidence, and considered the arguments made on behalf of both parties. This Board now makes its decision as follows:

OPINION

COYLE, Member--The question in this formal excise tax appeal is whether the Commerce and Due Process Clauses of the United States Constitution prohibit Washington from requiring the Taxpayer to collect the state's use tax (RCW 82.12) with respect to sales made in Washington where its employees were present in Washington for 95 days during the six-year audit period. We find the Taxpayer's presence in Washington was sufficient to permit the state to impose a use tax collection responsibility, and sustain the Department's assessment.

FACTS

Dynamic Information Systems Corporation (Taxpayer), a Colorado corporation, develops and sells computer software. The Taxpayer's principal product is various versions of OMNIDEX, which improves speed and flexibility of text retrieval (such as key word searches) from a particular type of database. The Taxpayer sells OMNIDEX in two main ways: by providing a uniform product for incorporation into other companies' information system products (value-added resellers, or "VAR's") and by direct sales of individual licenses to use the soft-ware, with each license being issued for a particular identified central processing unit. The Taxpayer employs sales representa-tives, on a salary-plus-commission basis, to make the direct sales of individual licenses.

APPENDIX 7-1

The Taxpayer's primary offices and operations are located in Boulder, Colorado. The Taxpayer sells its OMNIDEX products, and related products and training, to users in Washington State. The Tax-payer has had no employees located in Washington, nor any office or storage facility in the state. Between 1990 and 1996, the Taxpayer did not have a sales representative based in Washington State. Rather, the Taxpayer accomplished most of its sales to Washington customers through nonresident representatives or other employees based in Boulder, Colorado, or in Southern California. Those representa-tives traveled to Washington when the travel was warranted.

Historically, the Taxpayer closed approximately 50 to 60 percent of its initial license sales through on-site demonstrations. Sales trips could also include servicing existing accounts or setting up training classes. These trips were authorized as needed, at the request of potential customers; the Taxpayer did not arrange them on any scheduled or regular basis. The Taxpayer approved such travel only where a representative could show in advance that he had suffi-cient appointments in one area with persons authorized to make purchasing decisions, consolidating several on-site visits into one trip where possible.

***2** The Taxpayer reconstructed its sales representatives' visits to the state from its assessment period travel expense records. During the assessment years in question, the Taxpayer's representatives made the following trips into Washington:

1990	2
1991	9
1992	6
1993	8
1994	4
1995	6
1996	3

The trips lasted from one to four days each by the Taxpayer's count, for a total of 95 days during the assessment period. These trips were primarily to demonstrate the Taxpayer's products in order to facilitate sales of initial licenses, but also included support for existing customers such as arranging training and promoting new products or applications. These trips effected contacts with existing or potential Taxpayer customers in Washington but frequently, as part of the same trip into Seattle, also included on-site visits with existing or potential customers in Oregon, British Columbia, or, occasionally, Idaho. Any sales agreements made in Washington were subject to approval and acceptance in Colorado.

The Department suggests that the Taxpayer understated the length of visits to Washington by its sales representatives, but since these visits on many occasions included contacts in Oregon and British Columbia, we have taken the Taxpayer's estimate of 95 set out above as an acceptable approximation of the number of days its sales represen-tatives spent contacting customers in Washington during the assessment period.

As existing sales representatives left and new representatives came on with the Taxpayer during the assessment period, its sales managers sometimes accompanied new representatives on sales trips, for training purposes. Dave Smith, who served as the Taxpayer's regional or national sales manager during the assessment period, recalled taking two of these trips into Washington during that period, and he believed that another national sales manager for the Taxpayer made additional training trips to Washington. The record contains no docu-mentary or other corroborating evidence to establish details such as dates and duration of trips by the Taxpayer's sales managers into Washington for sales representative training.

When no Taxpayer sales representative was available to respond to Washington customers, the Taxpayer would send an-

other sales repre-sentative from another territory, or a sales manager, or another trained employee, such as a technician who could give sales presenta-tions. The record also contains no details about trips by these other employees into Washington during the assessment period.

One of the Taxpayer's major customers in Washington was the Boeing Company (Boeing). Boeing held an unusually high number of OMNIDEX licenses, perhaps 30, during the period in question. Boeing's structure and use of OMNIDEX licenses was unique among the Taxpayer's customers. That relationship called for ongoing assistance (charac-terized by the Taxpayer's witness as "organizational") from the Taxpayer to keep Boeing's licenses in line with its internal changes and to familiarize new or transferred Boeing personnel with the OMNIDEX product, new related products or applications, and training opportunities (which were offered in Boulder and in California). The evidence does not reveal whether the Taxpayer's employees other than sales representatives entered Washington to provide such support to Boeing, but does establish that Boeing's needs justified a visit by a sales representative every year to acquaint persons at Boeing with OMNIDEX, new products, and training, and that Boeing's activities justified a re-working of its license agreements with the Taxpayer about every three years.

*3 The Taxpayer made sales to Washington customers in the approx-imate gross amount of $1.4 million during the audit period. Of that amount, approximately $280,000 ($41,480 per year) was attributable to sales of initial licenses. Since each license sale was worth approximately $15,000, this annual average represents sales of between three and four initial licenses per year. The sales constituting the remainder of the gross sales amount generally would not depend on representative visits to the state, for example, sales of software upgrades, renewal and maintenance charges, training, and sales to VAR's.

The Department audited the Taxpayer's records of sales for the period January 1990 through September 30, 1996, and assessed against the Taxpayer liability for unpaid sales and use taxes, business and occupation (B&O) taxes, and interest and penalties. In deriving the amount of the Taxpayer's income subject to Washington State sales and/or use taxes, the Department excluded from its computation sales to VAR's and receipts from training seminars provided to customers in out-of-state locations.

The Taxpayer paid the assessment under protest, and sought a refund from the Department of overpaid taxes. The Department denied the refund request by Determination 98-014, dated February 24, 1998.

ANALYSIS AND CONCLUSIONS

I

§Washington's sales tax is imposed on each retail sale in this state. RCW 82.08.020. Every retailer who engages in business activity within this state is required to collect sales tax. RCW 82.08.050. As a corollary to its sales tax, Washington imposes a use tax on property purchased for use in Washington under circumstances where the sales tax has not been paid. RCW 82.12.020. Retailers who engage in business activities in this state are required to collect the use tax at the time of sale. RCW 82.12.040 provides:

> (1) Every person who maintains in this state a place of business or a stock of goods, or engages in business activities within this state, shall obtain from the depart-ment a certificate of registration, and shall, at the time of making sales, or making transfers of either possession or title or both, of tangible personal property for use in this state, collect from the purchasers or transferees the tax imposed under this chapter. For the purposes of this chapter, the phrase "maintains in this state a place of business" shall include the solicitation of sales and/or taking of orders by sales agents or traveling representatives. For the purposes of this chapter, "engages in busi-ness activity within this state" includes every activity which is sufficient under the Constitution of the United States for this state to require collec-

tion of tax under this chapter. The department shall in rules specify activi-ties which constitute engaging in business activity within this state, and shall keep the rules current with future court interpretations of the Constitution of the United States.
(Emphasis supplied.)

*4 The Department's rule governing use tax collection responsibility for out-of-state sellers, WAC 458-20-221, provides in pertinent part:

(1) Statutory requirements. RCW 82.12.040(1) provides that every person who maintains a place of business in this state, maintains a stock of goods in this state, or engages in business activities within this state must obtain a certificate of registration and must collect use tax from purchasers at the time it makes sales of tangible personal property for use in this state. The legislature has directed the department of revenue to specify, by rule, activities which constitute engaging in business activities within this state. These are activities which are suffi-cient under the Constitution of the United States to require the collection of use tax.
(2) Definitions.
(a) "Maintains a place of business in this state" includes:
. . .
(ii) Soliciting sales or taking orders by sales agents or traveling representatives.
(b) "Engages in business activities within this state" includes:
(i) Purposefully or systematically exploiting the market provided by this state by any media-assisted, media-facilitated, or media-solicited means, including, but not limited to, direct mail advertising, unsolicited distribu-tion of catalogues, computer-assisted shopping, telephone, television, radio or other electronic media, or magazine or newspaper advertisements or other media . . . .
. . .
(c) "Purposefully or systematically exploiting the market provided by this state" is presumed to take place if the gross proceeds of sales of tangible personal property delivered from outside this state to destinations in this state exceed five hundred thousand dollars during a period of twelve consecutive months.
. . .
(4) Obligation of sellers to collect use tax. Per-sons who obtain a certificate of registration, maintain a place of business in this state, maintain a stock of goods in this state, or engage in business activities within this state are required to collect use tax from persons in this state to whom they sell tangible personal property at retail and from whom they have not collected sales tax. Use tax collected by sellers shall be deemed to be held in trust until paid to the department. Any seller failing to collect the tax or, if collected, failing to remit the tax is personally liable to the state for the amount of tax. (For exceptions as to sale to certain persons engaged in inter-state or foreign commerce see WAC 458-20-175.)

The upshot of these statutory and regulatory provisions insofar as relevant to this appeal is: (1) a seller who sends its employees and agents into Washington to solicit sales thereby "maintains a place of business in Washington"; and (2) a seller who "systematically or purposefully" exploits the market provided by Washington is engaged in business activities in Washington. In either case, the seller is required to collect the use tax on sales for use in Washington. It is the express policy of Washington to enforce this use tax collection responsibility up to--but not beyond--the outer margin of the United States Constitution.

II

*5 The Taxpayer argues its presence in Washington is insufficient to give rise to a sales/use tax collection responsibility consistent with the United States Constitution. It further contends that most of its sales to Washington customers should

be disregarded as "dissociated", that is, not related to any activity of its sales representatives in this state, and thus not subject to the state's taxing authority. Finally, the Taxpayer requests that all interest and penalties be waived in light of the unsettled law in this area of interstate taxation.

At the hearing, the Department withdrew its claim against the Taxpayer for all B&O taxes, but maintained its position that it has the authority to require the Taxpayer to collect and remit Washington use taxes on the Taxpayer's sales of licensed products to Washington purchasers.

A. Due Process Claim.
The Due Process Clause is primarily concerned with historical and cultural notions of "fair play and substantial justice" between the government and its citizens. Milliken v. Meyer, 311 U.S. 457, 463 (1940). Consistent with the Due Process Clause, a state may require an out-of-state seller to collect sales/use tax where the seller has purposefully availed itself of the benefits of an economic market in the taxing state. Quill Corp. v. North Dakota, 504 U.S. 298 (1992). Purposeful exploitation of the market state gives the seller "fair warning" that it may be subject to the laws of that state. Id. Physical presence of the seller is not required. Id.

The Taxpayer's sales representatives or other employees entered Washington on an average of 5.6 times per year during the assessment period. Sales into Washington were not steady, but neither were they only sporadic; they continued at a substantial level each year throughout the assessment period. We see as especially significant that the Taxpayer sent salespeople or other employees only where it felt there was justification for the trip expenses. The presence in Washington of the Taxpayer's employees was clearly deliberate and purposeful. We infer that the justification was economic, that the company would not have incurred the expense unless it expected to see an adequate return in terms of sales. These decisions to send personnel to visit Washington we characterize as demonstrating an economic activity intended to establish or maintain the Taxpayer's market in Washington. We see continuing, purposeful activity by the Taxpayer in Washington establishing a definite link with this state and putting the Taxpayer on notice that it might be subject to all of Washington's laws (including use tax collection responsibility) in regard to the activities of its employees in Washington. The Taxpayer's activity in Washington during the assessment period was more than sufficient to establish nexus for Due Process purposes.

B. Commerce Clause Claim.
Nexus for Commerce Clause purposes requires a distinct exam-ination. The nexus question under the Commerce Clause is whether subjecting an out-of-state seller to a use tax collection requirement places an "undue burden" on interstate commerce. Quill, supra. In the absence of a "safe harbor" rule categorically exempting certain commercial activity from state taxation (e.g., mail order sales), the analysis depends upon a "case by case evaluation of the actual burdens imposed by particular regulations or taxes." Quill, supra. These burdens must be evaluated in light of the fundamental purpose of the Commerce Clause: the creation and maintenance of a vibrant national economy free from hindrance and suppression at the hands of local interests.

***6** The onus is on the Taxpayer to establish the actual burdens imposed by Washington's use tax collection requirement, and to show how these burdens (if any) impermissibly restrict the Taxpayer's participation in the Washington market for its products. A person seeking exemption from taxation has the burden of showing all the facts which would entitle such person to the exemption. Norton Co. v. Department of Revenue, 340 U.S. 534 (1951); Standard Pressed Steel Co. v. Department of Revenue, 10 Wn. App. 45, 516 P.2d 1043 (1973). The Taxpayer has made no such showing here.

We have considered the Quill Court's admonition that the sheer multiplicity of jurisdictions imposing use taxes might unduly burden interstate commerce. See Quill, supra, f.n. 6. But we do not take the Court's language as an indication that it

would find use tax collection to be an undue burden where the out-of-state seller regularly and systematically sends its employees or agents into the taxing state to solicit sales. Indeed, since the demise of the "Drummer cases", the Court has always determined that regular in-state sales solicitation activity by a company's employees or agents specifically directed at in-state customers is sufficient to pass muster under the Commerce Clause nexus tests. See, e.g., Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959); Tyler Pipe Indus. v. Washington State Dep't of Revenue, 483 U.S. 232 (1987).

It may be that there is some de minimus standard for physical presence; but the modern cases emanating from the United States Supreme Court demonstrate that regular, purposeful in-state sales solicitation activities by employees or sales agents specifically directed at in-state customers is sufficient as a matter of law to meet the "substantial nexus" prong of the test in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). In this connection, a case cited by the Taxpayer, Florida Dep't of Revenue v. Share Int'l, Inc., 667 So. 2d 226 (Fla. App. 1995), aff'd 676 So. 2d 1362 (Fla. 1996) is instructive. In that case, the Florida courts held that the presence of company personnel and display of products at an annual three-day trade fair was insufficient to establish nexus for use tax collection on mail order sales. The company did, however, collect sales tax on goods sold during the trade fair, and there was no claim that the company was exempt from this collection responsibility due to lack of nexus. In the case of the mail order sales, the in-state sales solicitation activities were not directed specifically at the company's in-state customers, but were directed at customers without regard to where they might reside. On the other hand, the sales solicitation activities resulting in Florida sales at the trade fair were by definition specifically directed at the company's in-state customers because all the sales took place to customers in Florida without regard to where the customer might reside. Thus, the Share International case also stands as much for the rule that where a seller's in-state sales solicitation activity is specifically directed at in-state customers, the seller may be required to collect a sales/ use tax without offending the nexus prong of the Complete Auto Transit test. There is nothing in Share International which is contrary to the Department's position.

*7 The Taxpayer characterizes its visits as "intermittent, irreg-ular, occasional, and nonsystematic." Brief for Appellant at 5. These are characterizations more useful in pre-Quill Due Process Clause analysis than in post-Quill Commerce Clause analysis. It is not the amount of in-state activity which controls; it is the purpose and effect of the in-state activities which provides the touchstone for "substantial nexus".

The purpose of the Taxpayer's physical presence in Washington was to make sales. Its personnel made more than five trips per year to Washington on average, trips that can only be characterized as sales trips, intended primarily to produce sales. They did produce sales directly, but they also served to initiate and preserve contacts and relationships with potential to produce sales later. The visits were not casual. They were planned for maximum exposure of the Taxpayer's products and services for the least travel time and expense. They were not regular in the sense of occurring at fixed intervals, but they were regular in the sense that they recurred over a significant period of time, whenever the need presented. They comprised 95 days of sales agent activity, not including training trips by sales managers.

The effect of the Taxpayer's sales activities in Washington were substantial. Its sales to Washington customers amounted to more than $1 million over the 6.76-year period at issue. To be sure, one cannot say for certain that the Taxpayer's in-state activities were solely responsible for its sales success. But we can be certain that the Taxpayer thought its in-state sales activities were essential to its sales effort; otherwise, the Taxpayer would not have spent the time and money to maintain a physical presence here. Throughout the assessment period, the Taxpayer never abandoned attempts to make sales to Washington businesses even though its major markets were elsewhere, but persisted in its sales efforts here, manifestly because its efforts were meeting with success.

We conclude that where a seller deliberately sends its sales force into a state for the purpose of soliciting sales from cus-

tomers located in that state, it thereby establishes a substantial nexus with that state, at least insofar as use tax collection responsibility is concerned. The purpose and effect of such in-state sales activities is to cloak the seller with the essential trappings of a local merchant: face-to-face, hand-to-hand contact. There is nothing in the purpose of the Commerce Clause which any longer requires a state to maintain a "hands off" posture with respect to such sellers.

III

An out-of-state seller which becomes liable for B&O taxes because of nexus-creating activities is permitted to "dissociate" other sales it makes in Washington which have no relation to the nexus-creating activities. Such a seller bears the "distinct burden" of proof on any claimed dissociated sales. WAC 458-20-193(7)(c). The Department has abandoned its claim to B&O tax liability in this matter, and thus we have not addressed the question of nexus for purposes of the B&O tax. However, this process of "dissociation" is not available where the tax obligation is for collection of sales or use tax. WAC 458-20-193(8) states in pertinent part: "If the seller is not required to collect retail sales tax on a particular sale because the transaction is disassociated from the instate activity, it must collect the use tax from the buyer."

***8** In National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551 (1977), the Court permitted imposition of use tax collection liability on an out-of-state seller where its in-state activities of soliciting advertising copy for its magazine were concededly unrelated to its mail order sales of tangible items to California residents. The court said that the relevant constitutional test for the imposition of use tax collection is the same as that for nexus with the taxing state under the Due Process Clause. The Court reasoned that a use tax collection obligation is less of a burden on interstate commerce because the state tax is imposed on state resident purchasers, and the out-of-state seller is merely the collection agent for the tax.

We have already concluded that the facts here meet the require-ments of minimum connection for the Due Process Clause. We can see no basis for dissociation of any of the Taxpayer's sales included in the Department's assessment of retail sales tax/use tax.

IV

The Taxpayer requests a refund of interest and penalties assessed by the Department. The interest and penalties were assessed because the Taxpayer did not timely register, collect, and pay over the use tax at the time of making the sales in Washington. See RCW 82.32.050 (interest); and RCW 82.32.090(1) (penalties). The Department did not assess the 10 percent penalty for failure to follow written instruc-tions. RCW 82.32.090(4).

The Taxpayer succinctly argues:

> Under WAC 458-20-228, both the interest and ten per-cent penalty for not voluntarily registering prior to being contacted by the Department can be waived by the Washington Department of Revenue "if the failure to pay any tax by the due date was due to circumstances beyond the control of the taxpayer." Since the case law is so unsettled, both as to the legal tests to be used as well as the varying results based on the facts, as to whether DISC's sales visits constituted nexus for Washington sales tax purposes, DISC's failure to voluntarily register was justified. Based on legal counsel throughout the audit period, DISC had a good faith belief that the sales visits were not "regular, systematic or purposeful"; but rather, occasional, ad hoc, "sporadic sojourns" that did not amount to Washington nexus.

Brief for Appellant at 6-7.

We have no doubt that at the margins, the question of nexus for use tax collection liability is open to debate. But the mere fact that one's tax liability is open to debate does not provide the grounds for waiving penalties and interest. The purpose of penalties assessed in this case against the Taxpayer is to secure timely payment of the tax. This purpose

would be defeated if a taxpayer could avoid any sanction for late payment merely by arguing that it had a "good faith belief" that the tax was not due. The late payment of taxes in this case is not due to "circumstances beyond the control of the taxpayer". The Taxpayer could at any time have inquired of the Department as to its use tax collection responsibility. Further, if the Taxpayer had read the administrative regulations governing the question of nexus (WAC 458-20-193 and -221), it would have discovered the Department's clear position with respect to nexus.

*9 We conclude the Taxpayer has not shown the Department erred in refusing to waive the applicable penalties and in- terest.

FINDINGS OF FACT

1. **Dynamic Information Systems** Corporation (Taxpayer), a Colorado corporation, develops and sells computer software. The Tax-payer's principal product is various versions of OMNIDEX, which improves speed and flexibility of text retrieval (such as key word searches) from a particular type of database. The Taxpayer sells OMNIDEX in two main ways: by providing a uniform product for incorpo-ration into other companies' information system products (value-added resellers, or "VAR's") and by direct sales of individual licenses to use the software, with each license issued for a particular identified central processing unit (CPU). The Taxpayer employs sales representa-tives, on a salary-plus-commission basis, to make the direct sales of individual licenses.

2. The Taxpayer sells its OMNIDEX products, and related products and training, to users in Washington State. Any sales agree-ments made in Washington were subject to approval and acceptance in Colorado.

3. The Taxpayer's primary offices and operations are located in Boulder, Colorado. The Taxpayer has had no employees located in Washington, nor any office or storage facility in the state. Between 1990 and 1996, the Taxpayer did not have a sales representative based in Washington State. Rather, the Taxpayer accomplished most of its sales to Washington customers through nonresident representatives or other employees based in Boulder, Colorado, or in Southern California. Those representatives traveled to Washington when the travel was warranted.

4. Historically, the Taxpayer closes approximately 50 to 60 percent of its sales through on-site demonstrations. Sales trips could also include servicing existing accounts or setting up training classes. These trips are authorized as needed, at the request of potential customers; the Taxpayer does not arrange them on any scheduled or regular basis. The Taxpayer approved such travel only where a representative could show in advance that he had sufficient appointments in one area with persons authorized to make purchasing decisions, consolidating several on-site visits into one trip where possible.

5. The Taxpayer reconstructed its sales representatives' visits to the state from its assessment period travel expense records. During the assessment years in question, the Taxpayer's representa-tives made the following trips into Washing- ton:

1990	2
1991	9
1992	6
1993	8
1994	4
1995	6
1996	3

6. The trips lasted from one to four days each by the Tax-payer's count, for a total of 95 days during the assessment period. These trips were primarily to demonstrate the Taxpayer's products in order to facilitate sales of initial licenses, but also included support for existing customers such as arranging training and promoting new products or applications. These trips effected contacts with existing or potential Taxpayer customers in Washington but frequently, as part of the same trip into Seattle, also included on-site visits with existing or potential customers in Oregon, British Columbia, or, occasionally, Idaho.

*10 7. As existing sales representatives left and new represen-tatives came on with the Taxpayer during the assessment period, its sales managers sometimes accompanied new representatives on sales trips, for training purposes. Dave Smith, who served as the Tax-payer's regional or national sales manager during the assessment period, recalled taking two of these trips into Washington during that period, and he believed that another national sales manager for the Taxpayer made additional training trips to Washington.

8. When no Taxpayer sales representative was available to respond to Washington customers, the Taxpayer would send another sales representative from another territory, or a sales manager, or another trained employee, such as a technician who could give sales presenta-tions.

9. One of the Taxpayer's major customers in Washington was the Boeing Company (Boeing). Boeing held an unusually high number of OMNIDEX licenses, perhaps 30, during the period in question. Boeing's structure and use of OMNIDEX licenses was unique among the Taxpayer's customers. That relationship called for ongoing assistance (charac-terized by the Taxpayer's witness as "organizational") from the Tax-payer to keep Boeing's licenses in line with internal changes and to familiarize new or transferred Boeing personnel with the OMNIDEX product, new related products or applications, and training oppor-tunities (which were offered in Boulder and in California).

10. Boeing's needs justified a visit by a sales representative every year to acquaint persons at Boeing with OMNIDEX, new products, and training, and that Boeing's activities justified a re-working of its license agreements with the Taxpayer about every three years.

11. The Taxpayer made sales to Washington customers in the approximate gross amount of $1.4 million during the audit period. Of that amount, approximately $280,000 ($41,480 per year) was attrib-utable to sales of initial licenses. Since each license sale was worth approximately $15,000, this annual average represents sales of between three and four initial licenses per year. The sales consti-tuting the remainder of the gross sales amount generally would not depend on representative visits to the state, for example, sales of software upgrades, renewal and maintenance charges, training, and sales to VAR's.

12. The presence in Washington of the Taxpayer's employees was clearly deliberate and purposeful. We find that the justification was economic, that the company would not have incurred the expense unless it expected to see an adequate return in terms of sales. These deci-sions to send personnel to visit Washington were activities intended to establish and maintain the Taxpayer's market in Washington. As shown by the Taxpayer's sales, the effect of the Taxpayer's activities was also to establish and maintain its market in Washington.

13. The Department of Revenue (Department) audited the Tax-payer's records of sales for the period January 1990 through Septem-ber 30, 1996, and assessed against the Taxpayer liability for unpaid sales and use taxes, business and occupation (B&O) taxes, and interest and penalties. In deriving the amount of the Taxpayer's income subject to Washington State sales and/or use taxes, the Department excluded from its computation sales to VAR's and receipts from training seminars provided to customers in out-of-state locations.

*11 14. The Taxpayer paid the assessment under protest, and sought a refund from the Department of overpaid taxes. The Department denied the refund request by Determination No. 98-014, dated February 24, 1998.

15. The Taxpayer filed its Notice of Appeal within 30 days of the Department's final determination.

Any Conclusion of Law which should be deemed a Finding of Fact is hereby adopted as such.

From these findings, this Board comes to these

CONCLUSIONS OF LAW

1. The Board has jurisdiction over the subject matter and parties to this appeal.

2. A person seeking exemption from taxation has the burden of showing all the facts which would entitle such person to the exemp-tion.

3. Washington imposes a use tax on the sale of tangible personal property and certain services with respect to purchases made for consumption in this state. The tax is imposed on the purchaser and is to be collected by the seller at the time of sale.

4. A seller located outside of Washington who sends its employ-ees or agents into Washington to solicit sales maintains a place of business in Washington.

5. A seller who systematically or purposefully exploits the market provided by Washington is engaged in business activities in Washington.

6. The Taxpayer is required to collect the use tax on sales of its products to Washington customers because it maintains a place of business in Washington and is engaged in business activities in this state.

7. Washington may, consistent with the Due Process Clause of the United States Constitution, require the Taxpayer to collect the use tax from its Washington customers because the Taxpayer's sales solicitation activities in Washington during the audit period demon-strated that the Taxpayer purposefully availed itself of the economic benefits of the Washington market. Such activities provided suffi-cient "nexus" with this state.

8. Once a seller's in-state activities establish sufficient "nexus" with a taxing state, e.g., where the seller purposefully avails itself of the economic benefits of the taxing state, the taxing state may require the seller to collect use tax on all sales made in the taxing state, including those which are not "associated" with the seller's in-state activities.

9. The Taxpayer may not "disassociate" its sales in Washington for use tax collection purposes.

10. Washington may, consistent with the Commerce Clause of the United States Constitution, impose a non-discriminatory use tax collection requirement on a seller whose in-state activities consist of regular, purposeful in-state sales solicitation activities by its employees and agents specifically directed at Washington customers.

11. The Taxpayer's in-state sales solicitation activities were regular, purposeful, and were specifically directed at in-state customers. The Commerce Clause does not prevent Washington from requiring the Taxpayer to collect the use tax on its Washington sales.

*12 12. The Taxpayer has failed to show that Washington's use tax collection requirement, as applied to the Taxpayer's

in-state activi-ties, places an impermissible burden on interstate commerce.

13. The Taxpayer has failed to show that the Department erred in refusing to waive otherwise applicable interest and penalties. A "good faith belief" that taxes are not due and owing is not grounds for waiving penalties and interest.

14. The Department's determination should be affirmed with respect to the use tax issues, and the matter should be remanded to the Department for correction of the assessment to reflect the fact that the Department has abandoned its claim for unpaid B&O tax.

Any Finding of Fact which should be deemed a Conclusion of Law is hereby adopted as such.

From these conclusions, this Board enters this

DECISION

The determination of the Department is affirmed with respect to the use tax issues. The matter is remanded to the Department for correction of the assessment to reflect the deletion of the Depart-ment's claim for unpaid B&O taxes.

DATED this 28th day of December, 2000.

Matthew J. Coyle
Chair

Ann Anderson
Vice Chair

2000 WL 33267349 (Wash.Bd.Tax.App.)
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Classifying State and Local Taxes: Current Controversies

by Walter Hellerstein and John A. Swain

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In preparing this article, Profs. Hellerstein and Swain draw freely from their forthcoming supplement (2009 No. 3) to the two-volume treatise, Jerome R. Hellerstein and Walter Hellerstein, State Taxation *(3rd ed. 1998-2009).*

The validity of a tax can depend on its classification. The U.S. Supreme Court's classification of the 1894 federal income tax on rentals, dividends, and interest as a "direct" tax on the underlying property that produced the income, rather than an indirect tax on the income itself, rendered the tax unconstitutional because it was not apportioned among the states according to population as required by Article I, section 9, clause 4 of the U.S. Constitution.[1] Even after the adoption of the 16th Amendment in 1913 giving Congress the power to "to lay and collect taxes on incomes, from whatever source derived, without regard to apportionment among the several States,"[2] the Court condemned as unconstitutional congressional efforts to impose taxes that the Court characterized as levies on the underlying property rather than on the income derived from that property.[3]

Although federal tax classification issues are now largely of historical interest,[4] tax classification issues continue to play an important role in the state and local tax arena. For example, questions arise whether levies are property taxes for purposes of state constitutional requirements of uniformity and equality, which often apply only to property taxes;[5] whether levies are income or sales taxes for purposes of a federal statute that prohibits levies (other than income and sales taxes) on persons working on federal property;[6] and whether levies are direct income taxes or indirect franchise taxes for purposes of a federal statute limiting state power to tax income from federal obligations.[7] In this article, we examine state tax classification issues in several contexts in which they have recently spawned controversy.

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[1]*Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, *aff'd on rehearing*, 158 U.S. 601 (1895).

[2]U.S. Const. Amend. XVI.

[3]*See, e.g., Eisner v. Macomber*, 252 U.S. 189 (1920) (invalidating tax on income associated with stock dividend as invalid tax on "property" that was not apportioned among the states by population).

[4]*See Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955) (adopting broad concept of income and discrediting earlier decisions embracing narrower definitions); *Murphy v. United States*, 493 F.3d 170 (D.C. Cir. 2007) (on rehearing), *cert. denied*, 128 S. Ct. 2050 (2008) (recanting suggestion in original decision that 16th Amendment limited Congress's power to define damages for nonphysical injuries as income). In academic quarters, however, the debate over federal tax classification issues continues to rage, which says more about academics than it does about the practical significance of the issue. *See* Bruce Ackerman, "Taxation and the Constitution," 99 *Colum. L. Rev.* 1 (1999); Joseph M. Dodge, "What Federal Taxes Are Subject to the Rule of Apportionment," 11 *U. Pa. J. Const. L.* 839 (2009); Erik M. Jensen, "The Apportionment of 'Direct Taxes': Are Consumption Taxes Constitutional?," 97 *Colum. L. Rev.* 2234 (1997); Erik M. Jensen, "The Taxing Power, the Sixteenth Amendment, and the Meaning of 'Incomes,'" 33 *Ariz. St. L. J.* 1057 (2001); Calvin H. Johnson, "The Apportionment of Direct Taxes: The Foul-Up at the Core of the Constitution," 7 *Wm. & Mary Bill of Rights J.* 1 (1998).

[5]*See, e.g., Douglas Aircraft Co. v. Johnson*, 90 P.2d 572 (Cal. 1939).

[6]*See, e.g., Johnson v. City and County of Denver*, 527 P.2d 883 (Colo. 1974).

[7]*See, e.g., Schwinden v. Burlington Northern, Inc.*, 691 P.2d 1351 (Mont. 1984).

(Footnote continued in next column.)

I. Classification of Business Gross Receipts Taxes as Sales Taxes for Purposes of *Quill*'s Physical-Presence Test of Substantial Nexus

In *Quill Corp. v. North Dakota*,[8] the U.S. Supreme Court held that the commerce clause's "substantial nexus" requirement prohibits a state from imposing a use tax collection obligation on an out-of-state vendor without physical presence in the state. If *Quill*'s physical-presence standard is limited to sales and use taxes as distinguished, for example, from corporate net income taxes — and for the moment at least, the case law strongly supports that distinction[9] — the characterization of a levy as a sales or use tax as distinguished from some other type of levy becomes critical to the constitutional analysis. Although many levies fall comfortably into one category or the other because they are easily identifiable as either traditional retail sales taxes imposed on "final" consumption[10] on a transaction-by-transaction basis or as traditional net income taxes that cannot reasonably be characterized as sales or use taxes, some levies are not so easily classified. In particular, general business activity taxes measured by gross receipts, such as Washington's venerable business and occupation tax,[11] and more recently enacted levies such as Ohio's commercial activity tax,[12] Michigan's business tax,[13] and Texas's business margins tax,[14] can raise issues as to their proper classification for nexus and other purposes.[15] Moreover, this is certain to be a vigorously contested issue regarding California's proposed business net receipts tax should it ever be enacted.[16]

A. General Analysis

In analyzing whether a particular levy should be characterized as a sales or use tax or as some other type of tax for purposes of *Quill*'s physical-presence test, one should first identify the reasons underlying the distinction and then determine whether those reasons justify treating the levy as a sales or use tax or as a different type of levy. Based on the Supreme Court's reasoning in *Quill* and on the large body of case law endorsing the distinction in the context of corporate income and franchise taxes,[17] the principal reasons for distinguishing sales and use taxes from other types of taxes are:

- the administrative difficulties for remote vendors in complying with tax collection obligations on a transaction-by-transaction basis in more than 6,000 state and local sales and use tax jurisdictions — difficulties that may not exist for other types of taxes;
- principles of *stare decisis*, specifically the 1967 decision in *National Bellas Hess*[18] establishing the physical-presence rule for use tax collection obligations for mail-order sellers — a decision arguably not controlling for other types of taxes; and
- reliance interests that the physical-presence rule had engendered in the mail-order industry, particularly with the threat of retroactive application of the rule — reliance interests that

[8]504 U.S. 298 (1992).

[9]*See, e.g., Geoffrey, Inc. v. Commissioner of Revenue*, 899 N.E.2d 87 (Mass.), *cert. denied*, 129 S. Ct. 2853 (2009); *Capital One Bank v. Commissioner of Revenue*, 899 N.E.2d 76 (Mass.), *cert. denied*, 129 S. Ct. 2827 (2009); *Lanco, Inc. v. Director, Division of Taxation*, 908 A.2d 176 (N.J. 2006), *cert. denied*, 551 U.S. 1131 (2007); *Tax Commissioner v. MBNA America Bank, N.A.*, 640 S.E.2d 226 (W. Va. 2006), *cert. denied*, 551 U.S. 1141 (2007); *see generally* 1 Jerome R. Hellerstein and Walter Hellerstein, *State Taxation*, para. 6.11 (3d ed. 2006 and Cum. Supp. 2009). (For the decision in *Geoffrey*, see *Doc 2009-471* or *2009 STT 6-13*; for the decision in *Capital One Bank*, see *Doc 2009-470* or *2009 STT 6-12*; for the decision in *Lanco*, see *Doc 2006-21177* or *2009 STT 199-22*; for the decision in *MBNA*, see *Doc 2006-23668* or *2006 STT 228-18*.)

[10]We use the term "final" consumption advisedly, because we are acutely aware that the U.S. retail sales tax falls in substantial part — by some estimates approximately 40 percent — on business purchases rather than household consumption. *See* 2 Hellerstein and Hellerstein, *supra* note 9, at para. 12.04[5]. If one includes within the concept of final consumption the use by businesses of goods and services that are not resold as such, then the statement in the text makes sense descriptively, even if it is makes no sense in terms of the normative standards for a good consumption tax, which would be limited to household consumption and would impose no economic burden on businesses. *See id.* at para. 12.06[1].

[11]Wash. Rev. Code Ann. section 82.04.220 (Westlaw 2009).

[12]Ohio Rev. Code Ann. section 5751.02 (Westlaw 2009).

[13]Mich. Comp. Laws sections 208.1101 et seq. (Westlaw 2009).

[14]Texas Tax Code Ann. section 171.002 (Westlaw 2009).

[15]In addition to the question of constitutional nexus standards, the classification of a levy measured in whole or in part by gross receipts as a sales tax, on the one hand, or as a business activity tax akin to an income tax, on the other, has implications for (1) the applicability of Public Law 86-272, which applies only to "net income" taxes, (*see* 1 Hellerstein and Hellerstein, *supra* note 9, at para 6.17); (2) whether the tax is deductible from other states' income taxes, which typically deny a deduction for income taxes, an issue we consider below (*see also id.* at para. 7.12); and (3) whether the tax needs to be apportioned, in the sense of dividing the tax base. *See* 2 Hellerstein and Hellerstein *id.* at paras. 18.06[3] and 18.06[3][d]; Walter Hellerstein et al., "Commerce Clause Restraints on State Taxation After *Jefferson Lines*," 51 *Tax L. Rev.* 47 (1995). Although each of these inquiries involves different concerns, there are enough common threads among them to lead the careful lawyer confronted with one of these issues to consider cases and rulings arising under each of these rubrics.

[16]*See* Commission on the 21st Century Economy, Proposed Tax Structure (Sept. 14, 2009). (For the full text, see *Doc 2009-20559* or *2009 STT 177-6*.)

[17]*See supra* note 9.

[18]*National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967).

taxpayers arguably could not claim for other taxes and for other industries.[19]

Although the matter is not entirely free from doubt, there appears to be a much stronger case for analogizing Washington's business and occupation tax, Michigan's business tax, and Texas's business margins tax to the income taxes to which courts have declined to extend *Quill*'s physical-presence nexus requirement than to sales and use taxes. The question of how to characterize Ohio's commercial activity tax may be a bit closer, although that tax appears to us more closely analogous to an income tax than to a retail sales tax. After setting forth our general views regarding these levies, we discuss the relevant case law and commentary regarding the levies in question. In this connection, it is important to note that the case law and commentary is very much in its formative stages (if it exists at all) for the more recently enacted levies from Ohio, Michigan, and Texas.

There appears to be a much stronger case for analogizing Washington's, Michigan's, and Texas's business taxes to income taxes than to sales and use taxes.

First, unlike sales and use taxes, which are generally imposed on a transaction-by-transaction basis, separately stated, and collected by the vendor from the consumer, the taxes described above are levies imposed on a periodic rather than a transactional basis, are not separately stated, and are not collected, as such, from the consumer.[20] In this respect, whatever administrative burdens are encountered by taxpayers subject to a general business activity tax resemble those confronting income taxpayers more closely than those confronting sales and use taxpayers.

Second, the direct bearing of the *Bellas Hess* decision — establishing the physical-presence requirement for sales and use taxes[21] that "has become part of the basic framework of a sizeable industry"[22] — seems no more pertinent to business gross receipts taxes than it does to income taxes.

Third, insofar as there are *stare decisis* and other reliance interests at stake, taxpayers subject to Ohio's commercial activity tax, Michigan's business tax, and Texas's business margins tax would have weaker cases than the taxpayers in *Quill*, who could claim a quarter century of justified reliance on existing precedent. By contrast, the Ohio levy did not become effective until 2005 and the Texas and Michigan levies did not become effective until 2008.

Finally, it is telling that each of the states under consideration — Washington, Ohio, Texas, and Michigan — already has a traditional retail sales tax as part of its tax structure. Although it is conceivable that a state would adopt a second levy, labeled a gross receipts tax, that in relevant structural aspects was similar to the preexisting sales tax, we doubt that this is what those state legislatures had in mind when adopting their business gross receipts taxes. In short, the very existence of a separate levy imposed *in addition to* and operating *along side of* a traditional retail sales tax supports the view that the taxes described above should be characterized as taxes other than a sales or use tax.

B. Case Law and Commentary

1. Washington Business and Occupation Tax

Although Washington courts have not carefully analyzed whether Washington's business and occupation (B&O) tax constitutes a sales and use tax or some other type of tax in terms of the criteria set forth above, two courts have concluded that the B&O tax is not subject to *Quill*'s physical-presence requirement. Thus, the Washington Court of Appeals, analyzing Seattle's B&O tax, which is in all relevant respects identical to the state's B&O tax, declared:

> The tax at issue here is neither a sales or use tax, nor is it a franchise tax. It is a business and occupation tax for the privilege of engaging in business within the City of Seattle. The automakers certainly exploit the market in the City, regardless of where they are physically located. We decline to extend *Quill*'s physical presence requirement in this context.[23]

Subsequently, another division of the Washington Court of Appeals disposed of the issue even more summarily:

> A close reading of *Quill* reveals that its language supports those courts that have limited *Quill* to cases involving sales and use taxes. . . . *Therefore*, the *Quill* language does not support [the taxpayer's] proposition that a physical

[19] *See generally* John Swain, "State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective," 45 *Wm. & Mary L. Rev.* 319 (2003).

[20] To be sure, the taxes may be passed on to purchasers, but that is a question of economic incidence, not tax administration.

[21] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[22] *Id.* at 317.

[23] *General Motors Corp. v. City of Seattle*, 25 P.3d 1022, 1029 (Wash. App. 2001), *review denied*, 35 P.3d 381 (Wash.), *cert. denied*, 535 U.S. 1056 (2002).

presence is required to establish substantial nexus in the context of B&O taxes.[24]

The use of the italicized word "therefore," though hardly a model of analysis, indicates that the court necessarily characterized the B&O tax as a levy distinguishable from a sales and use tax.[25]

2. Ohio Commercial Activity Tax

Ohio's commercial activity tax (CAT), which contains a provision asserting nexus without regard to a taxpayer's physical presence in the state,[26] is being challenged on the grounds that, among other things, the nexus provision is unconstitutional under *Quill*.[27] While Ohio courts have not yet reached the merits of that question, the recent decision of the Ohio Supreme Court in *Ohio Grocers Association v. Levin*[28] strongly supports the view that the CAT should not be characterized as a sales or use tax, despite earlier authority that supported the opposite conclusion.

In *Ohio Grocers*, the court considered the question whether the CAT, as applied to those engaged in selling food, violated the state constitutional prohibitions against (1) any "excise tax . . . upon the sale or purchase of food for human consumption"[29] and (2) any "sales or other excise tax . . . upon any wholesale sale . . . of food for human consumption . . . or in any retail transaction, on any packaging that contains food for human consumption."[30]

In the course of its opinion concluding that "the CAT is not an excise tax 'upon the sale or purchase of food' and does not violate the Ohio Constitution,"[31] the court described the CAT in terms that clearly distinguish it from the sales and use taxes considered in *Quill*. Thus, after noting that "the CAT is levied 'on each person with taxable gross receipts for the privilege of doing business in the state,"[32] the court addressed the ultimate question in the case: "[I]s the CAT what it purports to be — a tax on the privilege of doing business? Or is it what it purports not to be — a tax on sales?"[33] The court answered that question unequivocally: "When the operation of the CAT is considered, one can only conclude that it is not a tax upon the sale or purchase of food."[34]

In elaborating on its answer, the court observed, among other things, that:

- the legislature described the tax as a tax on doing business;
- the tax is imposed on the person enjoying the privilege;
- the tax may not be billed or invoiced to a person other than the holder of the privilege;
- the tax is imposed for an annual privilege;
- the tax is calculated "based on results over business periods (either annually or quarterly), not transaction by transaction"[35];
- the tax is neither triggered by a sale of food nor necessarily reflected in the sales price of food;
- the CAT cannot be added to the price of food at the cash register; and
- the CAT does not apply to a seller's receipts from food when the seller has less than $150,000 of gross receipts during a year.

The court concluded that "the relationship between a sale of food and CAT obligations is so attenuated and unpredictable that it simply cannot be said that the CAT operates as a tax upon the sale or purchase of food."[36] It did "not do so formally, nor must it do so practically."[37] In short, "the notion that the CAT 'operates' as a sales tax — which is collected from purchasers, imposed at the point of sale, and computed by multiplying the sale price by the applicable rate — is factually incorrect."[38]

The Ohio Supreme Court's *Ohio Grocers* decision should largely undermine any claim based on earlier decisions that the CAT should be analogized to a sales and use tax subject to *Quill*'s strictures, assuming that *Quill*'s strictures are limited to such taxes. In the court below, the Ohio Court of Appeals had rejected the tax commissioner's contention that the CAT is "not equivalent to a sales or transactional

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[24]*Lamtec Corp. v. Department of Revenue*, __ P.3d ___, ___ (Wash. App. 2009) (emphasis supplied).

[25]Earlier in its opinion, however, the *Lamtec* court provided more analytical content to this distinction, albeit in the context of the state law issue of whether the place of "sale" was relevant to the application of the B&O tax:

> [S]ales tax is inherently different from B&O tax. In *Ford Motor*, the Washington Supreme Court emphasized this inherent difference:
>
> > Looking at the place of sale is proper in the sales tax context because the incident of tax in that situation is the individual transaction. Such is not the case where a B&O tax is involved because . . . the B&O tax is imposed upon activities associated with the privilege of doing business in the taxing jurisdiction.
>
> *Id.* (quoting *Ford Motor Co. v. City of Seattle*, 156 P.3d 185, 190 (Wash. 2007), *cert. denied*, 128 S. Ct.1224 (2008)).

[26]Ohio Rev. Code Ann. section 5751.01(I)(3) (Westlaw 2009) (defining persons with substantial nexus with the state as including taxpayers with taxable gross receipts of at least $500,000 without regard to physical presence).

[27]*See Overstock.com, Inc. v. Levin*, No. 08 CV 16412, Ct. of Common Pleas, Franklin Cty., Ohio, July 27, 2009 (dismissing complaint on procedural grounds).

[28]Slip Opinion No. 2009-Ohio-4872 (Sept. 17, 2009). (For the decision, see *Doc 2009-20741* or *2009 STT 179-18*.)

[29]Ohio Const. Art. XII, section 3(C).

[30]Ohio Const. Art. XII, section 13.

[31]*Ohio Grocers*, Slip Opinion No. 2009-Ohio-4872 at 2.

[32]*Id.* at 3 (*quoting* the statute).

[33]*Id.* at 14.

[34]*Id.*

[35]*Id.* at 15.

[36]*Id.* at 17.

[37]*Id.*

[38]*Id.*

tax,"[39] declaring that "by its very operation when applied to gross receipts derived from the sales of food, a transactional tax is precisely what the CAT becomes."[40] The court believed that "[t]his is so because the tax is measured *solely* by gross receipts and is based on aggregate sales, including those from the sales of food."[41] Needless to say, in light of the Ohio Supreme Court's reversal of the court of appeals decision, taxpayers can no longer take any comfort from that language.

For the same reason, an earlier Ohio Court of Appeals opinion that characterized the CAT as a sales tax must be regarded with considerable caution in light of the state supreme court's decision in *Ohio Grocers*. The case involved a contract dispute requiring the city of Toledo to pay costs incurred by the contractor, including "all sales, consumer, use and other similar taxes."[42] The Ohio Court of Appeals held that the CAT was a sales tax for purposes of the contractual provision at issue. The city contended that the CAT was an annual privilege tax for the privilege of doing business in the city and was not a "transactional tax . . . 'similar to' 'sales, consumer, and use' taxes as contemplated by the contract to be shifted to the city."[43] The court rejected that contention: "Since the amount of tax owed is tied to the amount of a business's gross receipts, the tax is similar to a sale or consumer tax and not an overhead tax."[44]

In sum, the Ohio Supreme Court's *Ohio Grocers* opinion has sharply distinguished Ohio's CAT from the traditional retail sales tax at issue in *Quill*. Moreover, insofar as earlier Ohio cases analogized the CAT to a sales tax, they did so on the ground that both levies were imposed on receipts. But that arguable economic equivalence between business gross receipts taxes and retail sales taxes does not speak to the distinction that the *Quill* opinion (and the state cases interpreting it) drew between sales and use taxes and other types of taxes not subject to *Quill*'s physical-presence test.[45] Rather, as we have observed above, it was the administrative concerns, and reliance interests associated with those concerns, that distinguished the two categories of levies. In this respect, as we have also suggested above and as the Ohio Supreme Court decision now makes clear, the CAT seems more analogous to an income tax because of the manner in which it is imposed and collected.

3. Michigan Business Tax

Like Ohio's CAT, Michigan's business tax (MBT) contains an economic nexus provision that defines substantial nexus to include "the active solicitation of sales in Michigan and Michigan Gross Receipts of at least $350,000."[46] That provision is certain to be the subject of litigation similar to that under way in Ohio, although there are understandably no reported cases at this early stage in the levy's life. Nevertheless, two respected commentators have argued, regarding the portion of the tax imposed on gross receipts (the modified gross receipts tax, or MGRT[47]), that it should not be classified as a sales or use tax within the meaning of *Quill*:

> The Michigan MGRT is not the type of traditional retail sales tax that was before the Court in either *Bellas Hess* or *Quill*. True, the tax may be intended to fall on consumption, similar to a sales or use tax. But the similarity ends there. Moreover, the *Quill* Court, at least to some extent, was protecting reliance interests based on *Bellas Hess*. Taxpayers under the Michigan MGRT have no claim to such protection. If the MGRT is not viewed as a sales or use tax, which seems likely, then the constitutionality of its economic-presence test turns on whether the physical-presence text must be satisfied for taxes other than sales or use taxes.[48]

II. Classification of Business Gross Receipts Taxes as Income Taxes for Purposes of Their Deductibility Under State Corporate Income Taxes

Most state corporate income taxes deny taxpayers deductions for others states' taxes measured by

[39] *Ohio Grocers Association v. Wilkins*, 897 N.E.2d 188, 193 (Ohio App., 10th Dist. 2008).

[40] *Id.*

[41] *Id.* (emphasis in original).

[42] *Mosser Construction, Inc. v. City of Toledo*, No. L-07-1060, 2007 WL 2745222, at *1 (Ohio Ct. of Appeals, 6th Dist. Dec. 21, 2007).

[43] *Id.* at *4.

[44] *Id.*

[45] In this respect, the issue parallels the dispute between the majority and the dissenting opinions in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995), in which the majority drew a line between sales and use taxes, as transaction taxes that did not require apportionment, and business gross receipts taxes that did require it, and the dissent chided the majority for ignoring the economic equivalence between the two types of levies. *See supra* note 15 and sources cited therein.

[46] Mich. Comp. Laws. Ann. section 208.1200(1) (Westlaw 2009).

[47] *Id.* at section 208.1203. The MBT consists of four separate taxes, only one of which raises the characterization issue discussed in the text. The other three taxes are the business income tax, *id.* at section 208.1201a traditional net income tax; a gross insurance premiums tax, *id.* at sections 208.1235(2), 208.1243(1)(a); and a bank capital tax on financial institutions. *Id.* at section 208.1263.

[48] Michael McIntyre and Richard Pomp, "A Policy Analysis of Michigan's Mislabeled Gross Receipts Tax," 53 *Wayne L. Rev.* 1275, 1303 (2008).

net income.[49] Three of the recently enacted statewide business taxes discussed above — Ohio's CAT, Texas's business margins tax, and Michigan's business tax — raise the question whether they should be classified as "income" taxes under provisions denying a deduction for those taxes.

A. Ohio Commercial Activities Tax

Effective July 1, 2005, Ohio imposed the CAT "on each person with taxable gross receipts for the privilege of doing business in this state."[50] The levy was designed to replace the state's corporate net income tax. In general, gross receipts means:

> the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person, including the fair market value of any property and any services received, and any debt transferred or forgiven as consideration.[51]

Tax administrators from states other than Ohio up to this point have been unanimous in their view that the CAT is deductible for state corporate income tax purposes and does not fall within the prohibition of deductions for "income" taxes. Thus, the Minnesota Department of Revenue ruled that the CAT is not a tax based on net income for purposes of its statutory requirement that taxpayers add back to their federal taxable income deductions for "taxes based on net income" paid to other states or any Canadian province.[52] The Massachusetts Department of Revenue concluded that the Ohio CAT is not an income tax, because the tax is "not based on income" and is "due whether a business is profitable or not."[53] The Kansas and South Carolina departments of revenue have likewise ruled that the Ohio CAT is deductible.[54]

B. Texas Margins Tax

Effective January 1, 2008, Texas converted its former franchise tax, which was measured by corporate net worth (often determined by "earned surplus" resembling net income), to a levy on an entity's "taxable margin."[55] An entity's taxable margin is defined as the lesser of 70 percent of the entity's total revenue from its entire business or an amount computed by:

> (i) determining the taxable entity's total revenue from its entire business . . . ;
>
> (ii) subtracting, at the election of the taxable entity, either:
>
> (a) cost of goods sold, . . . ; or
>
> (b) compensation, . . . ; . . . and
>
> (iii) subtracting . . . compensation [paid to certain members of the armed forces].[56]

The Minnesota Department of Revenue has taken the position that the Texas margins tax is not a tax based on net income for purposes of its statutory requirement that taxpayers add back to their federal taxable income deductions for taxes based on net income paid to other states or any Canadian province.[57] While recognizing that the alternative calculation provides some deductions for compensation and cost of goods sold,[58] the department does not view the overall levy as a net income tax, because it "does not provide other deductions such as interest, depreciation, and most other business expenses generally associated with a computation of net income."[59]

The Virginia Department of Revenue has similarly concluded that the Texas margins tax is not a tax based on or measured by net income and that it need not be added back to Virginia taxable income, because the tax "excludes the vast majority of normal business expenses normally permitted in determining net income."[60] Observing that the Texas margins tax "does not generally allow the deductions that would be allowed by a tax imposed on net income," and that "the Texas Legislature has specifically stated that the [margins tax] is not an income tax,"[61] the Massachusetts DOR concluded that the tax is not an income tax for Massachusetts tax purposes.

Not all state taxing authorities agree with that conclusion, however. For example, the Kansas Department of Revenue has taken the position that the

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[49]Miscellaneous Deductions — Part III, *All States Tax Guide* (RIA) para. 228-E (chart) (2009), *available at* http://www.checkpoint.riag.com; Deduction for Federal Income Taxes, *All States Tax Guide* (RIA) para. 230 (chart) (2009), *available at* http://www.checkpoint.riag.com.

[50]Ohio Rev. Code Ann. section 5751.02 (Westlaw 2009).

[51]*Id.* section 5751.01(F).

[52]Minnesota Dep't of Revenue, Notice 08-08, July 21, 2008, *available at* http://www.checkpoint.riag.com.

[53]Directive 08-7, Mass. Dep't of Revenue, Dec. 18, 2008, *available at* http://www.mass.gov.

[54]Kansas Dep't of Revenue, Office of Policy and Research, Op. Ltr. O-2009-005, Mar. 24, 2009, *available at* http://www.checkpoint.riag.com.; SC Revenue Ruling 09-10, SC Dep't of Revenue, July 17, 2009, *available at* http://www.checkpoint.riag.com.

[55]Texas Tax Code Ann. section 171.002 (Westlaw 2009).

[56]*Id.*, at section 171.001(a).

[57]Minnesota Department of Revenue, Notice 08-08, July 21, 2008, *available at* http://www.checkpoint.riag.com.

[58]*Id.*

[59]*Id.*

[60]Ruling of the Comm'r, PD 08-169, 2008 WL 4372042, *1 (Va. Dept. Tax'n, Sept. 11, 2008).

[61]Directive 08-7, Mass. Dep't of Revenue, Dec. 18, 2008, *available at* http://www.mass.gov.

Texas margins tax "is based on income and is therefore in the nature of an income tax."[62] The tax, therefore, "will be an addback modification for Kansas corporate income tax purposes."[63] Similarly, the Missouri Department of Revenue, relying on the state supreme court's somewhat idiosyncratic definition of an income tax,[64] concluded that the Texas margins tax is an income tax because it is "compensatory" in nature and will apply to compensate the state for public benefits, even if the entity ceases to do business in the state.[65] The South Carolina Department of Revenue has likewise ruled that the Texas margins tax is an income tax for which no deduction from the South Carolina tax base is permitted.[66]

California takes the position that the determination of whether the Texas margins tax is an income tax for purposes of its deductibility under the state income and franchise tax (as well as its creditability for state personal income tax purposes) "is highly fact-specific and must be made on a case-by-case basis."[67] Because there are three different methods for calculating the taxable margins (70 percent of total revenue, revenue less cost of goods sold, or revenue less compensation), taxpayers must determine in light of their individual circumstances, and the method they have chosen to calculate their margins tax, whether the margins tax constitutes a gross receipts tax, a gross income tax, or a net income tax. A taxpayer may deduct the margins tax only if it is properly characterized as a gross receipts tax.

C. Michigan Business Tax

Effective January 1, 2008, Michigan replaced its single business tax[68] with the MBT.[69] As noted above, the MBT contains several components, including a business income tax and a modified gross receipts tax.[70] The Missouri DOR ruled that the MBT is an income tax for purposes of the credit the state grants against Missouri personal income taxes for income taxes paid to other states, because "the business income tax and the modified gross receipts tax are based on an income base similar to federal taxable income" and "would be considered to be an income tax in Missouri" since "it is essentially 'based on' federal income tax."[71] The Kansas and South Carolina departments of revenue have ruled that the income-based portion of the MBT is not deductible, but that the modified gross receipts portion of the MBT is deductible.[72]

III. Classification of Tax as State or Local for Purposes of Federal Prohibition of Local Tax on Direct-to-Home Satellite Service

While Congress permits states and localities to impose franchise fees on cable service up to 5 percent of the cable operators' annual gross revenues from cable services,[73] it forbids localities, but not states, from imposing any taxes or fees on direct-to-home satellite service, which competes directly with cable service. Congress has declared that "a provider of direct-to-home satellite service shall be exempt from the collection or remittance, or both, of any tax or fee imposed by any local taxing jurisdiction on

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[62]Kansas Dep't of Revenue, Office of Policy and Research, Op. Ltr. O-2008-004, Sept. 2, 2008.

[63]*Id.*

[64]*See Herschend v. Director of Revenue*, 896 S.W.2d 458 (Mo. 1995) (*en banc*). According to *Herschend*, as described by the department:

> The "critical distinction" between the operation of a tax as a franchise tax or as an income tax is that a franchise tax is payable in advance for the privilege of exercising the right to do business in the future, whereas an income tax is compensatory for benefits received and is due even if the corporate entity ceases to exist and discontinues doing business in the state. Although the TMT [Texas margins tax] is called a franchise tax, before a corporation doing business in Texas can dissolve it must satisfy all tax liabilities. In other words, the corporation must pay the TMT due even if the corporation ceases doing business in the state. The TMT is a compensatory tax that "operates" as an income tax. Per the *Herschend* . . . test, the TMT is an "income tax" for the purposes of [Missouri law].

Priv. Ltr. Rul. No. LR5309, Missouri Dep't of Revenue, Dec. 12, 2008, *available at* http://www.checkpoint.riag.com.

[65]*Id.* The ruling involved whether individual partners were entitled to a credit against their Missouri personal income taxes for their proportionate share of the Texas margins tax that the partnership paid to Texas.

[66]SC Revenue Ruling 09-10, South Carolina Dep't of Revenue, July 17, 2009, *available at* http://www.checkpoint.riag.com.

[67]California Franchise Tax Board, FTB Notice 2009-06 (July 20, 2009), *available at* http://www.checkpoint.riag.com.

[68]*See* 1 Hellerstein and Hellerstein, *supra* note 9, at para. 7.12[5].

[69]Mich. Comp. Laws sections 208.1101 et seq. (Westlaw 2009).

[70]For a detailed analysis of the gross receipts component of the tax, see McIntyre and Pomp, *supra* note 48.

[71]Priv. Ltr. Rul. No. LR5309, Mo. Dep't of Revenue, Dec. 12, 2008, *available at* http://www.checkpoint.riag.com. The department also relied on the fact that "the 'object' of the MBT is to operate as an income tax and be compensation for benefits received." *Id.* Under Missouri case law, (*see Herschend v. Director of Revenue*, 896 S.W.2d 458 (Mo. 1995) (*en banc*), described in *supra* note 64), the compensatory nature of a tax is a criterion for determining whether it constitutes an income tax as distinguished from a privilege tax.

[72]Kansas Dep't of Revenue, Office of Policy & Research, Op. Ltr. O-2009-005, Mar. 24, 2009, *available at* http://www.checkpoint.riag.com.; SC Revenue Ruling 09-10, S.C. Dep't of Revenue, July 17, 2009, *available at* http://www.checkpoint.riag.com.

[73]Cable Communications Policy Act of 1984, 47 U.S.C. section 542(b); *see* 1 Hellerstein and Hellerstein, *supra* note 9, at para. 4.25[1][k].

direct-to-home satellite service."[74] To ensure that taxing authority is retained at the state level, however, Congress provided that the legislation "shall not be construed to prevent taxation of a provider of direct-to-home satellite service by a State or to prevent a local taxing jurisdiction from receiving revenue derived from a tax or fee imposed and collected by a State."[75]

Kentucky legislation authorizes local district boards of education to levy a utility gross receipts tax, and provides that a utility gross receipts license tax initially levied by a school district board of education includes the gross receipts derived from the furnishing of direct broadcast service.[76] Providers of direct broadcast satellite (DBS) service challenged school board taxes levied under to the statute on the grounds that they were preempted by federal law barring local taxes on DBS service. The Kentucky Court of Appeals had sustained the levy on the grounds that that school taxes are state taxes[77] and therefore fell within the savings clause for state-level taxes on DBS service.

On appeal, however, the Kentucky Supreme Court reversed, concluding that the levies violated both the language and purpose of the federal prohibition.[78] The court acknowledged that school taxes were regarded as state taxes for many purposes under Kentucky law, but rejected the contention that this saved the taxes from preemption because the application of federal law was not dependent on state law: "Thus Kentucky's particular view of school taxes is not a, much less the, determining factor in preemption analysis."[79] Rather, what mattered was Congress's view of the taxes at issue. On that question, the court had little doubt as to their proper interpretation:

> While the Department [of Revenue], an agent of the Commonwealth, collects the taxes for the various districts, it is undisputed that the taxes are actually imposed on a district-by-district, and not a statewide basis. In short, when the challenged gross receipts taxes are evaluated in light of the language employed by Congress, they appear to be expressly preempted.[80]

The court further observed that its conclusion based on a reading of the language of the statute was reinforced by the statute's purpose, viewed in light of its legislative history. The history revealed that Congress was concerned with burdening DBS providers with the requirement of complying with taxes in thousands of local taxing jurisdictions. That was the rationale for preempting local but not state taxing authority. Accordingly, the court ruled that viewed in light of the federal statute's legislative history, "Kentucky's gross receipts license tax entails precisely the locality-by-locality administrative burdens Congress intended to preempt."[81]

IV. Conclusion

First-year law students are admonished never to answer a classification question in the abstract, and tax professionals should remember the same. One must always ask the additional question: "For what purpose?" This article illustrates that point. As we have discussed, for example, the characterization of the Ohio CAT for purposes of *Quill's* physical-presence test might be different from its characterization for purposes of an Ohio constitutional prohibition against excise taxes on food, which, in turn, might be different from its characterization for the purposes of the state income tax deduction allowed by other states. In addition to asking for what purpose, tax advisers must also ask, "In which state?" For purposes of state income tax deductibility, for instance, the Texas margins tax will be treated as an income tax in Kansas but not in Minnesota. Thus, there are no universal answers to the question of tax classification. A proper response requires a careful case-by-case analysis and is often informed by the policies underlying the constitutional, statutory, or other legal rule at issue. ☆

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[74]Pub. L. No. 104-104 , Tit. VI, section 602 , 110 Stat. 144 (1996), 47 U.S.C.A. section 152 (note).

[75]*Id.*

[76]Ky. Rev. Stat. section 160.614 (Westlaw 2009).

[77]*Treesh v. DirecTV, Inc.*, No. 2006-CA-001983-MR, 2007 WL 2561555 (Ky. Ct. App. Sept. 7, 2007), *rev'd*, ___ S.W.3d ___ (Ky. 2009). (For the decisions, see *Doc 2007-20781* or *2007 STT 177-7.*)

[78]*DirecTV, Inc. v. Treesh*, ___ S.W.3d ___ (Ky. 2009). (For the corrected opinion, see *Doc 2009-20891* or *2009 STT 182-15.*)

[79]*Id.*

[80]*Id.*

[81]*Id.*

APPENDIX 8-8